Supreme Court, U.S.
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No. _____ 10-365

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In The

Supreme Court of the United States

HIGHLAND CRUSADER OFFSHORE PARTNERS LP, *et al.*,

Petitioners,

v.

LIFECARE HOLDINGS, INC.; LCI HOLDCO, LLC; JPMORGAN CHASE BANK, NA,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Petitioners respectfully submit the following questions for the Court's review:

1. When a substantive issue of state law is unsettled or difficult to ascertain, what are the absolute limits of a federal court's power to resolve the issue? Should the federal court assume the full powers of a state's highest court, as suggested by the Third Circuit; should it leave the elaboration of state law entirely to state courts, as suggested by the Seventh Circuit; should the federal court adopt a liability-limiting approach adopted at times by the Third, Sixth and Seventh Circuits; or should it adopt the majority-rule approach followed at times by the First, Fifth, Seventh and Eleventh Circuits?

2. Should the numerous splits in the federal circuits concerning substantive issues of state law be resolved by adopting a "home circuit rule," which would require federal courts to defer to the state-law decisions of the federal circuit that includes the state in question?

3. In interpreting the contract law of New York, did the Fifth Circuit correctly join the Ninth Circuit in holding that a violation of the duty of good faith can occur only when an explicit contractual right has been violated; or, should the Fifth Circuit have followed the Second and Third Circuits which hold the exact opposite – that a breach of this duty *cannot* stem from a violation of the terms of the contract; or, alternatively, is the correct interpretation one that falls somewhere in between, following the various positions adopted by the Eighth, Tenth or Eleventh Circuits?

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioners Highland Crusader Offshore Partners, L.P., Highland Credit Strategies Fund, Highland Distressed Opportunities, Inc., Highland Floating Rate Advantage Fund, Highland Floating Rate, LLC, Restoration Opportunities Fund, Highland Credit Opportunities Fund CDO L.P., and Highland Funds I, on behalf of its Highland High Income Series, have no parent corporations, and no publicly held company owns 10% or more of any petitioner. Petitioners will collectively be referred to as "Highland." They were the plaintiffs in the District Court and the appellants in the Court of Appeals.

As identified in the caption, the respondents are LifeCare Holdings, Inc.; LCI Holdco, LLC and JPMorgan Chase Bank, NA (collectively "Defendants"). They were the defendants in the District Court and the appellees in the Court of Appeals.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Highland Crusader Offshore Partners LP, *et al.*, respectfully petition for a writ of *certiorari* to review a decision of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The Court of Appeals' opinion below is unpublished. (App. 1-14). The Court of Appeals addressed appeals from two different orders of the District Court for the Northern District of Texas, which collectively dismissed all of Highland's claims against the Defendants. Only one of those orders, rendered August 27, 2008, is the subject of the present petition, and that order is unpublished. (App. 15-52). In that order, the District Court, *inter alia*, dismissed Highland's claim for breach of the implied covenant of good faith and fair dealing. Following the Court of Appeals' affirmation of dismissal, Highland timely filed a petition for rehearing *en banc*. (App. 56-84). The Court of Appeals denied Highland's petition. (App. 53-55).

STATEMENT OF JURISDICTION

The Court of Appeals' decision to deny rehearing was entered on June 14, 2010. (App. 55). This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

When it interprets state law, the federal judiciary stands in a form of fiduciary relationship to the states. Federal courts are duty-bound to apply state law faithfully. However, a federal court's erroneous interpretation or modification of state law cannot ordinarily be corrected, because state courts do not have the power to review federal decisions.

Despite the importance of the autonomy of the States to the federal system, the precise outer limits of federal jurisdiction to modify state law have never been properly articulated. In *Erie R.R. v. Tompkins* and its subsequent line of cases, this Court has spelled out federal courts' duty to apply state law faithfully, but has never properly defined how a federal court should rule when an issue of state law is unsettled. The federal circuits are deeply divided both on the issue of how much discretion a federal court may exercise when standing in the shoes of a state's highest court, and on how countless specific issues of state law should be properly applied. The Fifth Circuit's decision in the instant case dramatically illustrates all of these divisions, each of which strikes at the heart of the federalist system.

This case raises important questions concerning the power of a federal court to modify an unsettled doctrine of state law, the proper way to achieve uniformity in federal application of state law, and the interpretation of New York's covenant of good faith and fair dealing. Both the first and third of these issues have deeply divided the Federal Courts of Appeal. The very fact that at least seven federal circuits have been called on to interpret New York's duty of good faith and fair dealing, resulting in at least four materially different interpretations, demonstrates that this is a state-law issue that is both unsettled and of broad national importance.

The fact that the federal courts have had ample opportunity to address this issue is unsurprising, given that all contracts entered into in the United States contain an implied covenant of good faith and fair dealing.[1] A substantial, and probably the largest, portion of these contracts is governed by the law of New York, which is the nation's financial and commercial hub. Because so many New York contracts affect commerce between interstate and international parties, a large number have been the subject of lawsuits in federal court based on diversity jurisdiction, pursuant to 28 U.S.C. § 1332. What is essentially an issue of state law has thus touched upon two important federal questions: how unsettled state law

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[1] Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv. L. Rev. 369, 404 (1980) (citing cases).

should be interpreted by federal courts, and how the accuracy and uniformity of state law should be maintained across the federal jurisdictions.

The duty of good faith and fair dealing provides a model example of an unsettled state-law issue, which has created division within the federal judiciary. The precise scope of this duty is poorly defined and amorphous across the States.[2] While omnipresent in American contracts, it is a duty "whose application has been ad hoc, yielding inconsistent results and depriving parties of the ability to predict what conduct will violate the covenant."[3] Federal courts faced with interstate contractual disputes have therefore been required to interpret this amorphous doctrine and give it substance, even though in all cases it is governed by state law. The issue of how to properly resolve an unsettled issue of state law without unduly infringing on state sovereignty has itself deeply divided the federal circuits, and a separate division has arisen involving the specific issue of New York's duty of good faith and fair dealing in at least seven Federal Courts of Appeals.[4]

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[2] Diamond & Foss, *Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery*, 47 Hastings L.J. 585, 585-86 (1996).

[3] *Id.*

[4] This division is exposed in detail *infra*, at 16-19.

Rather than being decided according to the state's law by which they are governed, contractual breach of good faith and fair dealing claims in today's federal judiciary are being decided – improperly – based on the federal circuit within which they are located, and the view of the doctrine that particular circuit has adopted. Since each Court of Appeals is free to interpret each state's law independently, there effectively exist myriad different "versions" of the doctrine in our judicial system, and this same problem affects countless other unsettled or incompletely-defined issues of state law. "Such judge-made uncertainty – both in the potentially broad obligation to act in good faith . . . and in the lack of precision in defining a standard for a breach . . . poses serious consequences for commercial activity[.]"[5] The economic effects of this doctrine are particularly significant in a time of national economic crisis, when the duties governing New York's financial industry should be both clear and robust.

In addressing the myriad divisions that unsettled issues of state law create in the federal judiciary, this Court need not decide this issue of state law, or turn itself into a court of last resort for unsettled state-law

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[5] Erb, *The Implied Covenant of Good Faith and Fair Dealing in Alaska: One Court's License to Override Contractual Expectations*, 11 Alaska L. Rev. 35, 37 (1994) (analyzing the economic effects of the duty of good faith and fair dealing in Alaska, but the author's arguments can easily be applied to the doctrine's effect on the national economy).

issues. Instead, this Court should permanently *outsource* the duty of assuring uniformity in application of unsettled state law to the Federal Courts of Appeals, by adopting a "Home Circuit Rule" already recognized in the Court of Appeals for the District of Columbia.[6] In place of the myriad interpretations of state law that exist in the federal courts, this Home Circuit Rule would create uniformity. This uniformity, along with the deference that would be afforded to each state's local Federal Court of Appeals, would in turn powerfully further "the twin aims of the *Erie* rule: discouragement of forum-shopping and avoidance of inequitable administration of the laws."[7]

Accordingly, this Court should grant *certiorari* in order to consider adopting the D.C. Circuit's Home Circuit Rule, and applying it in the proceeding below.

FACTUAL BACKGROUND

In 2005, Defendants LifeCare, Inc. and LCI Holdco, LLC (collectively "LifeCare" or "Defendants") entered into a Credit Agreement through which they obtained significant loans from a number of creditors, including Highland. Defendant JPMorgan Chase

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[6] *See Charter Oil Co. v. Am. Employers' Ins. Co.*, 69 F.3d 1160, 1164 (D.C. Cir. 1995), *citing Abex Corp. v. Md. Cas. Co.*, 252 U.S. App. D.C. 297, 790 F.2d 119, 125-26 (D.C. Cir. 1986).

[7] *Chambers v. NASCO, Inc.*, 501 U.S. 32, 52 (1991) (*citing Hanna v. Plumer*, 380 U.S. 460, 468 (1965)).

Bank, NA was both a lender and LifeCare's administrative agent under the Credit Agreement. The Agreement provided the terms by which it could be amended, and allowed LifeCare to obtain an amendment in some instances by obtaining approval from lenders holding more than 50% of the total credit commitment. (App. 3). The procedures by which LifeCare was to solicit lender approval, and the duties it owed towards the lenders when soliciting approval, were not detailed in the Agreement.

In December, 2005, LifeCare was in the process of soliciting approval for a Second Amendment to the Credit Agreement. In seeking the First Amendment, LifeCare had comported with industry practice by soliciting all lenders simultaneously and giving all lenders an opportunity to respond to the incentive offer. LifeCare followed this practice initially, when seeking the Second Amendment, by posting an incentive offer of 75 basis points (bps) to lenders, but failed to obtain approval at this price. Highland was among the lenders who declined this initial offer, in hopes of obtaining a higher incentive from LifeCare. (App. 4-5).

Highland's decision to seek a better incentive offer was greeted with hostility by LifeCare, which responded by declaring a "battle royale with Highland." (App. 63). LifeCare then made a secret, side offer of 125 bps that was never disclosed either to Highland or to numerous other lenders, even though both Highland and many of these other lenders may have accepted the higher offer, or even a lower offer

that would have been in LifeCare's economic self-interest.[8] To keep Highland and these other lenders in the dark, LifeCare willfully withheld the contact information of the other lenders.[9] LifeCare's "battle royale" strategy worked, and it was ultimately able to make a 125 bps side-deal with two hand-picked lenders, which deliberately excluded Highland.

Every witness in the case, including Defendants' witnesses, testified that they could not identify a single instance in which a borrower was permitted to, or even attempted to, enter into a "secret side deal" such as the one used by LifeCare to exclude Highland. (App. 61). Instead, it is industry practice for every proposed amendment to be brought to all lenders' attention, and for the proposed amendment, all related information, and consent forms to be posted to a secure website for all lenders to review.[10] In order to avoid claims for breach of good faith and fair dealing from other lenders, LifeCare then "voluntarily" paid the higher, 125 bps incentive to all approving lenders, in tacit acknowledgment of the fact that a "secret side deal" did not comport with industry practice or fair dealing. (App. 5).

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[8] *Id.*

[9] *Id.*

[10] *Id.*

PROCEEDINGS BELOW

A. The District Court Proceedings.

On December 21, 2007, Highland filed a complaint in the 191st Judicial District Court of Dallas County, Texas, alleging a variety of claims against the Defendants. On January 22, 2008, Defendant JPMorgan filed a notice of removal, consented to by all Defendants, pursuant to 12 U.S.C. § 632. On May 15, 2008, the Federal District Court for the Northern District of Texas denied Highland's motion to remand. On August 27, 2008, the District Court issued an order dismissing, *inter alia,* Highland's claim for breach of the implied covenant of good faith and fair dealing.

In reaching this result, the District Court essentially married Highland's good faith and fair dealing claim to its breach-of-contract claim, disposing of both for the same reasons and holding that "[t]he analysis would be the same whether the Court considers this claim as breach of an express provision of the contract (Section 3.02) or as a breach of the implied covenant of good faith and fair dealing; therefore, the Court will consider these claims together." (App. 5). This was in line with the theory of good faith and fair dealing proposed by the Defendants, who had taken the position that "the covenant [of good faith] cannot add a substantive provision not included in the contract." (App. 28). The District Court "agree[d] with the Defendants' second argument that the implied covenant cannot create a new . . . obligation and

[found] dismissal appropriate on that ground." *Id.* The District Court quoted *Reiss v. Fin. Performance Corp.* for the proposition that "the parties knew how to restrict [their counter-party's] ability to amend if they so desired."[11] (App. 29).

In arriving at a definition of good faith and fair dealing, the Federal District Court for the Northern District of Texas had a duty to faithfully apply New York law.[12] The District Court accordingly ran through a laundry list of isolated legal statements from New York Courts and federal courts applying New York law, glossing over the significant fact that these opinions contradicted each other fundamentally. For instance, the District Court quoted the Seventh Circuit Court of Appeals for the proposition that a breach of good faith involved a violation of "the spirit, although *not the letter*, of a contract."[13] (App. 29). In the following sentence, it elaborated on this principle by quoting a New York appellate opinion, which clearly stated that the contractual duty of good faith could be used to enforce "promises" not explicitly included in the agreement. *Id.*[14]

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[11] 97 N.Y.2d 195 (N.Y. 2001).

[12] *See Erie R. R. v. Tompkins*, 304 U.S. 64, 79 (1938).

[13] *Quoting Harris Trust & Sav. Bank v. E-II Holdings, Inc.*, 926 F.2d 636, 642 (7th Cir. 1991) (citation omitted) (emphasis added)

[14] *Citing Havel v. Kelsey-Hayes Co.*, 83 A.D. 2d 380, 445 N.Y.S. 2d 333 (N.Y. App. Div. 1981).

Despite the fact that the District Court adopted a position directly contrary to the statements it had just quoted, it went on to cite, and agree, with the opposite position elaborated in *Reiss*: that the doctrine of good faith and fair dealing could not create new, extra-contractual duties, or any new "promises" outside of those explicitly defined in the contract. (App. 29-36).

In reaching this conclusion on New York law, the District Court cited four Federal opinions (covering New York's local District Courts and local Court of Appeals, as well as the Seventh Circuit) and four New York State Court opinions (covering all levels of the state judiciary from the Supreme Court to the New York Court of Appeals). The District Court made no distinction in the amount of weight that should be given to lower or higher state court opinions. Indeed, the New York state court decision the District Court relied on most heavily was *Oppman v. IRMC Holdings, Inc.*, a decision of the state's lowest trial court of general jurisdiction. (App. 33-36).[15]

The District Court failed to acknowledge the tension contained in the fundamentally opposed statements of New York law it examined, some of which asserted that the duty of good faith and fair dealing closely followed the terms of an agreement,[16]

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[15] *Discussing Oppman*, 14 Misc. 3d 1219A, 836 N.Y.S. 2d 494 (N.Y. Sup. Ct. 2007).

[16] *See, e.g., Oppman*, 14 Misc. 3d 1219A.

others of which stated it was capable of implying extra-contractual duties,[17] and did not address the issue of whether, when faced with an unsettled issue of state law, it should be guided by decisions of state or federal courts, by decisions of lower or higher state courts, by outside sources of law, by a "majority rule" across U.S. jurisdictions, by a rule that limited liability, or by its own judgment. It merely chose to follow one line of New York cases, and ignored another.

B. The Court of Appeals' Decision.

Highland timely filed a notice of appeal to the Fifth Circuit Court of Appeals appealing the above-cited District Court order, as well as another order of April 21, 2009, which dismissed the remaining claims brought by Highland. A panel of Judges Demoss, Elrod and Haynes affirmed the District Court's grant of summary judgment in all respects on May 10, 2010. (App. 1-14). On May 24, 2010, Highland filed a petition for rehearing *en banc*. (App. 56-84). That petition was denied on June 14, 2010. (App. 53-55).

Unlike the District Court, the Court of Appeals did not borrow from both federal and state authority in applying New York law, although it cited no reason for this shift. It cited exclusively to New York state opinions – two from the New York Court of Appeals, and two from the state's intermediate Appellate

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[17] *See, e.g., Havel*, 83 A.D. 2d 380, 445 N.Y.S. 2d 333.

Division. Among the cases cited by the Fifth Circuit in its opinion was *Dalton ex rel. Dalton v. Educ. Testing Serv.*, a decision from the New York Court of Appeals which adopted an interpretation of the duty of good faith and fair dealing directly contrary to that articulated in *Reiss* and relied on by the District Court. (App. 10).[18] However, the Fifth Circuit below only acknowledged *Dalton* as an afterthought among a long string of citations, and did not address the conflict between the principles announced in *Dalton* and *Reiss*.[19]

Instead, like the District Court, the Fifth Circuit simply chose one line of New York cases over another. Notably, it interpreted a particular New York appellate decision, *Jaffe v. Paramount Commc'ns, Inc.*,[20] as standing for the proposition that "[b]ecause Highland has failed to plead that LifeCare's and JP Morgan's actions deprived it of any benefit that it bargained for in the Credit Agreement . . . the district court properly dismissed Highland's good faith claim." (App. 10-11). In other words, following this holding, a plaintiff cannot maintain an action for breach of good faith and fair dealing under New York law in the Fifth

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[18] *Citing Dalton*, 663 N.E.2d 289, 291 (N.Y. 1995) (holding that the duty of good faith can be used to imply "reasonable" extra-contractual promises, and that it prohibits any arbitrary or irrational exercise of discretion, even if such arbitrary behavior does not violate explicit contractual terms).

[19] *Id.*

[20] 644 N.Y.S. 2d 43, 47-48 (N.Y. App. Div. 1996).

Circuit, unless the plaintiff *pleads* a breach of contract as the foundation of its good faith claim (in other words, a deprivation of a "benefit that it bargained for in [its contract]").[21]

In so doing, the Fifth Circuit glossed over, among numerous other precedents, *Richbell Info. Servs., Inc. v. Jupiter Partners, L.P.*, a decision of New York's Appellate Division which explicitly acknowledged the "tension" in New York cases "between, on the one hand, the imposition of a good faith limitation on the exercise of a contract right and, on the other hand, the avoidance of using the implied covenant . . . to create new duties[.]"[22] This explicit acknowledgment by a New York authority – that New York's duty of good faith and fair dealing is an unsettled doctrine governed by contradictory pronouncements – was addressed by Highland in its appellate brief. Rather than attempting to resolve this "tension," the Court of Appeals simply adopted one of several possible versions of New York law and moved on, satisfied that it had fulfilled its *Erie* duty by citing to New York opinions.

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[21] *Id.*

[22] 309 A.D.2d 288, 302 (N.Y. App. Div. 2003). *See also Gross v. Empire Healthchoice Assur., Inc.*, 2007 NY Slip Op. 51390U (N.Y. Sup. Ct. July 18, 2007) ("New York courts have repeatedly affirmed that a party may be in breach of an implied duty of good faith and fair dealing, even if it is not in breach of its express contractual obligations.") (citations omitted).

REASONS FOR GRANTING THE PETITION

A. This Court Should Grant Certiorari to Resolve the Longstanding Division in the Federal Circuits Concerning Proper Resolution of Unsettled Issues of State Law.

In 1938, this Court opened the modern era of federal jurisprudence on state-law issues by recognizing, in *Erie R. R. v. Tompkins*, that federal oversight of state judicial action is "an invasion of the authority of the State and, to that extent, a denial of its independence."[23] Federal judges were prohibited from substituting their own judgment for that of their state colleagues, because "no clause in the Constitution purports to confer such a power upon the Federal Courts."[24] Through this central holding of *Erie,* this Court has placed the federal judiciary in a form of fiduciary relationship to the states. This is because "[t]here is a curious asymmetrical twist to [the federal judicial system]. A federal court's erroneous application of state law cannot be corrected, because a state supreme court – the authoritative voice of state law – has no power to review federal judgments."[25]

This Court should grant *certiorari* in order to resolve the most significant division in the Federal Courts of Appeals that has emerged under *Erie* principles in

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[23] 304 U.S. 64, 79 (1938).

[24] *Id.* at 78.

[25] Meador, *Transformation of the American Judiciary*, 46 Ala. L. Rev. 763, 768 (1995).

the last seventy years: the question of how a federal court should react when confronted with an unsettled issue of state law. This issue is significant because, it is precisely when confronted with an unclear state-law issue that federal courts are most likely to substitute their own judgment for that of state judges, and "inva[de] the authority of the State[.]"[26]

This Court should provide guidance to the Fifth Circuit Court of Appeals, which in its hasty application of New York law has failed to so much as recognize that it was dealing with an unsettled issue on which New York opinions are divided. The proper identification and resolution of such unsettled issues is a matter of utmost importance to the proper balance of the federal system, because it is precisely when confronted with an unsettled state-law issue that federal judges are faced with a heightened risk of using their own judgment to resolve state issues, despite the fact that "no clause in the Constitution purports to confer such a power upon the Federal Courts."[27]

While *Erie* and its progeny have provided guidance to the federal courts in carrying out their duty to faithfully apply state law, this Court has issued no authoritative guidance concerning how a federal court should exercise its *Erie* judgment when faced with an issue over which state courts have conflicted, and

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[26] *Id.* at 79.

[27] *Id.* at 78.

which the state's highest court has either not addressed, or for which it has articulated conflicting principles.[28]

This Court has recognized that a federal court must be cognizant when a state court opinion it relies on has been overshadowed by subsequent developments, when a "fracture in the rules announced in those cases has appeared in subsequent rulings or dicta . . . [or] legislative movement is under way in [the state] to change the result of those cases . . . [or]

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[28] In the decades immediately following its landmark decision in *Erie*, this Court issued numerous decisions expanding on *Erie* principles, but all of this guidance takes for granted that a state's law will be readily determinable and not governed by an internal conflict. Shortly after *Erie*, in *Wichita Royalty Co. v. City Nat'l Bank*, this Court announced the basic principle that in ascertaining state law the federal courts should be guided by the jurisprudence of the highest court of that state. 306 U.S. 103 (1939). These decisions are only to be modified if that court itself has indicated that "its pronouncement will be modified, limited or restricted." *West v. Am. Tel. & Tel. Co.*, 311 U.S. 223, 236 (1940). If the state's highest court has not addressed an issue, the federal court must seek state law from other sources, and it "is not free to reject the state rule merely because it has not received the sanction of the highest state court." *Id.* at 236-37. federal courts are bound by the decisions of the appellate courts of the state "where there is no convincing evidence that the law of the state is otherwise." *Six Cos. of Cal. v. Joint Highway Dist.*, 311 U.S. 180 (1940); *Fid. Union Trust Co. v. Field*, 311 U.S. 169, 178 (1940) (same). When the state's highest court has not authoritatively ruled on an issue, the federal court "must apply what they find to be the state law after giving 'proper regard' to relevant rulings of other courts of the State. In this respect, it may be said to be, in effect, sitting as a state court." *Comm'r v. Estate of Bosch*, 387 U.S. 456, 465 (1967).

there appears to be . . . confusion in the [state] decisions."[29] These instances – where there is "fracture," "movement" towards change, or "confusion" in state jurisprudence – can be said to be instances where a state's law is unsettled. The difficulty, as made evident in the proceedings below, is that a state court opinion rarely contains a warning sign alerting the federal court that a state issue is unsettled, and that the opinion in question may not be authoritative. New York opinions governing good faith and fair dealing are overshadowed by precisely such a doctrinal conflict.[30]

As the Third Circuit recognized in *McKenna v. Ortho Pharm. Corp.*, "[t]he problem of ascertainment arises when, as here, the highest state court has not yet authoritatively addressed the critical [state] issue."[31] This may involve a case where the state's highest court has not addressed an issue at all, or where its jurisprudence is not dispositive of the case at bar, or conflicting. While this Court's *Erie* guidance has made clear that "disposition of such cases must be governed by a prediction of how the state's highest court would decide were it confronted with the problem," this task is so speculative the federal courts

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[29] *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 205 (1956).

[30] *Richbell*, 309 A.D. 2d at 302 (acknowledging the tension in New York cases).

[31] 622 F.2d 657, 661-662 (3d Cir. 1980).

have compared it to "crystal-ball gazing."[32] Nonetheless, "it is a task which [Federal Courts] may not decline."[33] The Federal Courts of Appeals are deeply divided on how to approach this crucial duty, whose precise contours literally define the boundary between state and federal judicial authority.

Numerous federal decisions have made clear that federal courts consider themselves relatively autonomous under *Erie* to decide an unsettled state-law issue. There is a wide scope of sources available for a federal court to justify its "*Erie* guess" regarding how a state's highest court would rule on an unsettled issue. These include sources from outside the state's courts, notably "decisions in other jurisdictions on the same or analogous issues."[34] They likewise include concepts as amorphous as "the general rule on the issue," "the rule in other states," and reliance on "other available legal sources, such as treatises and law review commentaries."[35]

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[32] *Id.*

[33] *Id.*

[34] *Leon's Bakery, Inc. v. Grinnell Corp.*, 990 F.2d 44, 48 (2d Cir. 1993) (citations omitted).

[35] *Jackson v. Johns-Manville Sales Corp.*, 781 F.2d 394, 397 (5th Cir. 1986) ("In vicariously creating state law . . . the Federal Court may consider all available legal sources, including the Restatements of Law, treatises, law review commentaries [and] decisions from other jurisdictions whose doctrinal approach is substantially the same[.]' "). *See also Western Forms, Inc. v. Pickell*, 308 F.3d 930, 933 (8th Cir. 2002) (similarly broad);

(Continued on following page)

The extent to which this lack of guidance, and the increasing volume of unsettled state-law issues that are decided in federal court, has empowered the federal judiciary is dramatically illustrated by *McKenna,* in which the Third Circuit overruled an earlier Ohio Supreme Court decision by adopting a rule that had been explicitly rejected by the state supreme court: that the statute of limitations on a medical malpractice claim begins tolling upon the patient's discovery of the malpractice.[36]

In exercising their *Erie* power to overrule the state's highest court, the federal panel in *McKenna* relied on the doctrine that "a federal tribunal should be careful to avoid the 'danger' of giving 'a state court decision a more binding effect than would a court of that state under similar circumstances,'" and noted that the highest state court, in whose shoes they were sitting, enjoys some latitude of decision regarding whether or not to follow state precedent.[37] The *McKenna* panel thus essentially concluded that Ohio's Supreme Court would overrule its own earlier explicit decision, and used that conclusion as justification for doing so in its place.[38]

Vigortone AG Prods., Inc. v. PM AG Prods., Inc., 316 F.3d 641, 644 (7th Cir. 2002) (same).

[36] *McKenna*, 622 F.2d at 662.

[37] *Id.* (*citing* 1A Moore's Federal Practice, ¶ 0.307, at 3077 (2d ed. 1979)).

[38] *See East Troy v. Soo L. R. Co.*, 653 F.2d 1123, 1129 (7th Cir. 1980) (confirming this interpretation of *McKenna*).

The approach of the federal circuits on this important federal issue has been not only divided, but confused, and in need of guidance. To illustrate the widely divergent approaches that the federal circuits have taken in grappling with this issue, one need only contrast *McKenna* with an approach followed by the Seventh Circuit, which has interpreted *Erie* as so great an injunction not to meddle in state law that "our policy will continue to be one that requires plaintiffs desirous of succeeding on novel state law claims to present those claims initially in state court," regardless of their merits.[39]

Apart from refusing to recognize new theories of state law, the Seventh Circuit has also, at times, constrained itself by adopting a "majority rule" approach, according to which "when state law on a question is unclear," a conclusive presumption is raised that "the state's highest court, should it ever be presented with the issues, will line up with a majority of the states."[40] Other Circuits have also followed this approach, though never consistently.[41]

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[39] *Birchler v. Gehl Co.*, 88 F.3d 518, 521 (7th Cir. 1996) (*quoting Shaw v. Republic Drill Corp.*, 810 F.2d 149, 150 (7th Cir. 1987)).

[40] *Vigortone AG Prods., Inc. v. PM AG Prods., Inc.*, 316 F.3d 641, 644 (7th Cir. 2002) (opinion by Judge Posner) (citations omitted).

[41] *See, e.g., Amherst Sportswear Co. v. McManus*, 876 F.2d 1045, 1048 (1st Cir. 1989); *Adkinson v. Int'l Harvester Co.*, 975 F.2d 208, 215 (5th Cir. 1992); *Wammock v. Celotex Corp.*, 835 F.2d 818, 820 (11th Cir. 1988)).

Absent further guidance from this Court, it remains unclear whether this amounts to a dutiful exercise in federal self-restraint, or an undue surrender of discretion which may lead to inaccurate "guesses" as to what a state's highest court would actually decide.

In addition, at least three Federal Courts of Appeals have held that when faced "with two opposing, yet equally plausible interpretations of state law . . . we generally choose the interpretation which restricts liability, rather than the more expansive interpretation which creates substantially more liability."[42] All of these approaches have attempted to address the issue of how best to apply *Erie* to an unsettled state-law question. However, absent further guidance from this Court, parties in federal court faced with an unsettled state-law issue engage in "crystal-ball gazing" when they attempt to predict what method the federal court in their case will choose to resolve the issue.

This Court should grant *certiorari* to address the methodology used by the District Court and Fifth Circuit below in addressing an important and unsettled issue of state law. However, in doing so, this Court should take into consideration another, even

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[42] *S. Ill. Riverboat Casino Cruises, Inc. v. Triangle Insulation & Sheet Metal Co.*, 302 F.3d 667, 676 (7th Cir. 2002) (*quoting Home Valu, Inc. v. PepBoys, Inc.*, 213 F.3d 960, 963 (7th Cir. 2000) (citation and internal quotation omitted)); *Werwinski v. Ford Motor Co.*, 286 F.3d 661, 680 (3d Cir. 2002); *Combs v. Int'l Ins. Co.*, 354 F.3d 568, 577 (6th Cir. 2004).

more fundamental problem in federal application of state law: the materially different manner in which the same state issues are being applied by different Federal Courts of Appeals, at the same time. New York's duty of good faith and fair dealing is an exemplar of this problem.

B. This Court Should Grant Certiorari to Consider Adopting a "Home Circuit Rule" to Resolve the Divisions in the Federal Circuits Governing Countless State-Law Issues.

Few issues of state law have received as much attention from the Federal Courts of Appeals as New York's covenant of good faith and fair dealing. This is because the covenant of good faith is contained in all contracts governed by American law,[43] many of which are governed by the law of New York, the nation's commercial center and financial hub. In applying New York law on this unsettled issue, the Courts of Appeals have not followed the same method of ascertainment, and have come to widely divergent conclusions.

In its opinion below, the Fifth Circuit held that Highland's claim for breach of good faith and fair dealing was properly dismissed "[b]ecause Highland has failed to plead that LifeCare's and JPMorgan's actions deprived it of any benefit that it bargained for in the Credit Agreement[.]" (App. 10-11). This narrow

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[43] *See* Burton, 94 Harv. L. Rev. at 404 (citing cases).

interpretation of the implied covenant has also been adopted by the Ninth Circuit.[44]

Under this view, the duty of good faith and fair dealing cannot be used to create extra-contractual duties. Since any violation of an explicit, "bargained for" contractual duty is difficult to distinguish from a breach of contract, this interpretation of New York law renders the doctrine of good faith and fair dealing largely redundant. Any plaintiff who can articulate a violation of a "bargained for" duty could recover in either case under breach of contract, and any plaintiff who cannot claim a breach of contractual terms will see their good faith and fair dealing claim dismissed, as happened to Highland in the proceedings below. Whatever "bargained for" duties did not make it into the terms of the contract, would be excluded by the parol evidence rule. Under this view, the duty of good faith and fair dealing is rendered either entirely redundant or made extremely narrow.

The Second Circuit, which is most familiar with New York law, as well as the neighboring Third Circuit, have analyzed the same body of precedent and adopted an interpretation of the duty of good faith and fair dealing that directly contradicts the

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[44] *See Monotype Corp. PLC v. Int'l Typeface Corp.*, 43 F.3d 443, 453 (9th Cir. 1994) ("Under New York law, or any other jurisdiction, an implied covenant theory does not give a court permission to supply additional terms to a contract for which the parties have not bargained.").

version of New York law adopted by the Fifth and Ninth Circuits. Relying on the New York Appellate Division's recent holding that "[a] cause of action for breach of the implied covenant of good faith and fair dealing cannot be maintained where the alleged breach is intrinsically tied to the damages allegedly resulting from a breach of contract," the Second Circuit has gone so far as to conclude that, under New York law, a cause of action *must* rest on extra-contractual violations to avoid dismissal for redundancy.[45] The breach of good faith *cannot* stem, or be intrinsically tied to, an explicit breach of contract – it must rest on independent conduct and independent damages.[46] This version of New York law has also recently been adopted by the Third Circuit, which has stated that "[u]nder New York law, a claim for breach of the implied covenant of good faith and fair dealing must be separate from any breach of contract," and dismissed a claim for breach of good faith and fair dealing because the "allegations essentially duplicate the allegations in [the] breach of contract claim."[47]

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[45] *Dist. Lodge 26, Int'l Assoc. of Machinists & Aerospace Workers, AFL-CIO v. United Techs. Corp.*, No. 10-0702-cv, 2010 U.S. App. LEXIS 13919 at *27 (2d Cir. July 8, 2010), *citing Deer Park Enters., LLC v. Ail Sys., Inc.*, 57 A.D. 3d 711, 712, 870 N.Y.S. 2d 89, 90 (N.Y. App. Div. 2008).

[46] *Id.*

[47] *Trianco, LLC v. Int'l Bus. Machs. Corp.*, 271 Fed. Appx. 198, 204 (3d Cir. 2008) ("Here, Trianco's allegations essentially duplicate the allegations in its breach of contract claim. Accordingly, dismissal was appropriate.").

This strictly *extra*-contractual approach is consistent with the theory that the implied covenant of good faith and fair dealing is meant to protect parties from malicious conduct which was not foreseen during their negotiations. Protection from such conduct would not have been "bargained for," precisely because it is unforeseen. LifeCare's secretive, aggressive conduct towards Highland in the proceeding below could well be a case in point, under the Second Circuit's interpretation.

A claim for breach of good faith cannot simultaneously involve the breach of a "bargained for" contractual duty, to survive dismissal in the Fifth or Ninth Circuit, and still be "separate from any breach of contract" so as to survive dismissal in the Second or Third Circuit. Nonetheless, all four of these Circuits purport to have accurately, and recently, applied New York law on this subject.

Further complicating this split, the Eighth, Tenth and Eleventh Circuits have interpreted New York law in a manner that incorporates elements of both of these approaches. The Eighth Circuit has held that the key issue for a breach of good faith and fair dealing under New York law is whether the contract grants one party a wide amount of discretion and, if so, that the party is prohibited from exercising that discretion in an arbitrary or irrational manner.[48] This

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[48] *McGrann v. First Albany Corp.*, 424 F.3d 743, 750 (8th Cir. 2005).

"reasonableness of discretion" "definition" of New York's implied covenant does not seem to coincide with either the strictly contractual or strictly extra-contractual approaches adopted by four of the other Circuits. A similar approach has been adopted by the Tenth Circuit.[49]

The Eleventh Circuit, meanwhile, has adopted a somewhat schizophrenic approach, by explicitly holding that a violation of good faith and fair dealing can occur "even if the express terms of the contract have not been breached," and then, in the same breath, rejecting a breach of good faith claim because "there has been no breach of the parties' bargained-for contractual rights."[50] Presumably, if the parties' rights were "bargained for" then they would be included in the contract, so it is difficult to understand how a breach should be pleaded within the Eleventh Circuit.

Under the current system, eleven Federal Circuit Courts of Appeals are free to adopt contradictory interpretations of the law of fifty U.S. jurisdictions,

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[49] *Pepsi-Cola Bottling Co. of Pittsburgh, Inc. v. Pepsico, Inc.*, No. 03-3134, 2006 U.S. App. LEXIS 20545 at *37-39 (10th Cir. April 11, 2006) (stating that breach of good faith is "merely a breach of the underlying contract," but also recognizing that PepsiCo "had a duty to take reasonable steps to prevent competing bottlers from encroaching on Pittsburgh Pepsi's exclusive territory[,]" even though such a duty was not explicitly bargained for in the contract).

[50] *Curtis Inv. Co., LLC v. Bayerische Hypo-Und Vereinsbank, AG*, 341 Fed. Appx. 487, 497 (11th Cir. 2009).

thus potentially creating over five hundred "versions" of state law in the federal judiciary. This independence in federal state-law jurisprudence engenders legal uncertainty in contractual relations, and forum shopping in federal court. There is no meritorious reason why New York law should be materially different when it governs a contract suit filed in federal court in Texas or New York. Indeed, the very fact that state law is being applied by the federal judiciary in materially inconsistent fashion constitutes the type of "interference" that "is an invasion of the authority of the State[s]" under *Erie*.[51]

A plaintiff, such as Highland in the proceeding below, could look towards the widely divergent interpretations of New York law in the federal circuits and rely on them in deciding whether to file suit in Texas or New York. Meanwhile, a defendant who found themselves in federal court in Texas would face a different "version" of New York law than a defendant who found themselves under federal jurisdiction in New York. The result is very patently contrary to "the twin aims of the *Erie* rule: discouragement of forum-shopping and avoidance of inequitable administration of the laws."[52]

One solution to this problem, which has been heavily suggested by academia, is to "employ a presumption in favor of certifying unsettled questions of

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[51] *Id.*

[52] *Chambers*, 501 U.S. at 52 (*citing Hanna*, 380 U.S. at 468).

state law to state courts whenever state law authorizes this procedure."[53] However, this solution is impractical due to extreme cost in time and resources that would be involved if every unsettled question of state law in federal court had to go through a separate certification procedure, and be separately decided by the state's highest court.[54] The dockets of the states' highest courts would quickly be clogged, and litigants would be frustrated because the already extensive delay and cost involved in pursuing a federal appellate decision would be increased dramatically.[55] A presumption in favor of certification might indeed comport with *Erie* principles, but be utopian in practical application.

There is, however, a more practical solution to this problem. It is already settled practice that, when dealing with an unsettled issue of state law, a federal court will generally look for guidance to decisions of the Federal District Courts that are within the state in question, and the Court of Appeals that contains the state within its jurisdiction. This is not only because a state's local federal courts supply the vast majority of federal decisions applying that state's law. In addition, precisely *because* they come into contact

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[53] Clark, *Ascertaining the Laws of the Several States: Positivism and Judicial Federalism after Erie*, 15 U. Pa. L. Rev. 1459, 1564 (1997).

[54] Glassman, *Making State Law in Federal Court*, 41 Gonz. L. Rev. 237, 249-52 (2005/2006).

[55] *Id.*

with it so frequently, these courts possess a greater degree of familiarity and expertise with that state's law, and are thus more authoritative on it, and more likely to apply it accurately and comprehensively.[56]

Uniformity in federal application of state law will be achieved if federal courts are required to recognize, as fully binding with the force of nationwide precedent, the interpretations of state law articulated by every state's local Court of Appeals. A "Home Circuit Rule," if adopted by this Court, would allow each federal circuit to exercise authority as an appellate court of last resort on unsettled issues of state law that fall within its geographic jurisdiction. Thus, rather than having five or six materially different "versions" of New York law in the federal courts, and the same multiplicity in applying the laws of the forty-nine other states, the federal courts will apply the law of each state uniformly, according to the state decisions on point and, if those are unclear or the issue is unsettled, according to the interpretation adopted by the Home Circuit. As the Courts of Appeals have already recognized, "[d]iversity jurisdiction, especially in its post-*Erie* incarnation, should not create needless diversity in the exposition of state

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[56] *See Charter Oil Co. v. Am. Employers' Ins. Co.*, 69 F.3d 1160, 1164, *citing Abex Corp. v. Md. Cas. Co.*, 252 U.S. App. D.C. 297, 790 F.2d 119, 125-26 (D.C. Cir. 1986) ("Judges of the home circuit are likely to be more experienced in the law of states within their circuit than are outsiders[.]").

substantive law."[57] A "Home Circuit Rule" would replace diversity in federal application of each state's law with uniformity.

Indeed, a Home Circuit Rule has already been adopted by one Federal Courts of Appeals, for these very reasons. The Federal Courts of Appeals for the D.C. Circuit has held that:

> The potential for forum-shopping within the federal judicial system caused by intercircuit conflicts over the meaning of state law, and the assumption of expertise on the part of the home circuit, have led us to conclude that a home circuit's view of state law is entitled to deference.[58]

It should be noted that this Home Circuit Rule does not unduly constrain a Federal Courts of Appeals' discretion, and does not allow a Home Circuit's determination to trump more recent state-law developments. The D.C. Circuit "will not follow another circuit's decision if that court 'ignored clear signals emanating from the state courts' or 'clearly misread state law.'"[59] However, in all other instances, federal

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[57] *In re Complaint of McLinn*, 739 F.2d 1395, 1401 (9th Cir. 1984) (*citing Factors Etc., Inc. v. Pro Arts, Inc.*, 652 F.2d 278, 283 (2d Cir. 1981), *cert. denied*, 456 U.S. 927, 72 L. Ed. 2d 442, 102 S. Ct. 1973 (1982)).

[58] *Indep. Petrochem. Corp. v. Aetna Cas. & Sur. Co.*, 944 F.2d 940, 945 (D.C. Cir. 1991), *citing Abex*, 790 F.2d at 125-26.

[59] *Id.*

deference to the home circuit is mandatory.[60] Since judges of the home circuit are more likely to possess expertise in applying that state's law, "such deference makes for uniform results taking advantage of that expertise."[61]

A new principle of horizontal *stare decisis* in federal application of state law would also more than likely lead to a greater federal deference to state law, in accord with the principles announced in *Erie*.[62] This is because it would vest authority to determine state law at the federal level in the Court of Appeals most familiar with the law of that state.

All of the factors which the federal courts have said *ought* to be taken into consideration to accurately apply state law – whether they be state court decisions, treatises on state law, state law review articles or state legislative enactments – are much more familiar to the local federal circuit than to an outside one. Thus, the local federal circuit will be less likely to misapply a state's law by having its attention drawn to isolated opinions by counsel, or simply by being unaware of the "tensions" that exist within

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[60] *Id.*

[61] *Charter Oil*, 69 F.3d at 1164, *citing Abex*, 790 F.2d at 125-26.

[62] *See Erie*, 304 U.S. at 79 (any federal meddling in state law, whether intentional or not, "is an invasion of the authority of the State and, to that extent, a denial of its independence").

state jurisprudence, as was the case in the District Court and Court of Appeals opinions below.

This Court should grant *certiorari* in order to consider adopting the D.C. Circuit's "Home Circuit Rule" as a binding doctrine of federal interpretation of state law. In addition to doing so, this Court should grant *certiorari* in order to better articulate the standards that home circuits should use in interpreting state law, and particularly the outer reaches of a federal court's authority when standing in the shoes of a state's highest court. In so doing, this Court should reverse the Court of Appeals' decision below, because it did not apply *any* coherent methodology to resolve an unsettled issue of state law, nor did it defer to the expertise and judgment of the Second Circuit, which has very recently adopted an interpretation of New York law directly contrary to that adopted in the opinion below by the Fifth Circuit.[63]

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[63] *Dist. Lodge*, 2010 U.S. App. LEXIS 13919 at *27, *citing Deer Park*, 57 A.D. 3d at 712, 870 N.Y.S. 2d at 90 (adopting the strictly *extra*-contractual interpretation of New York's duty of good faith and fair dealing, in contrast to the Fifth Circuit below, which has adopted the opposite, strictly contractual interpretation).

C. This Court Should Grant Certiorari Because the Nation Can Ill Afford for a Narrow Duty of Good Faith to Govern New York's Financial Industry.

The Fifth Circuit's opinion below was wrongly decided, in part because it relied on isolated statements by New York courts and ignored a contrary line of state precedent, and in part because it came to the dangerous conclusion that a breach of good faith and fair dealing can occur *only* if an explicit contractual provision has been violated. This interpretation limits claims for breach of good faith to those which are duplicative of claims for breach of contract, and releases the parties under New York contracts from any *additional* obligation to behave equitably and openly towards their contractual partners. The behavior of the Defendants below is a perfect illustration of the risks of limiting the duty of good faith to those duties explicitly spelled out in a contract, and refusing to apply the doctrine to control bad faith behavior unforeseen by the parties.

Apart from merely being wrongly decided, the Fifth Circuit's decision below comes at a moment when the United States can ill afford to have its legal system encroach on economic recovery. There are hundreds of billions, and perhaps trillions of dollars of debt in the financial industry which are syndicated under Credit Agreements nearly identical to the one governing LifeCare's debt in the proceedings below. Many of these agreements are governed by the law of New York, where the financial industry is centered.

LifeCare's behavior – departing from its own previous practice, and industry standards, by pursuing a secret "side deal" to amend a Credit Agreement – is indisputably both secretive and aggressive. The question is: does it also breach the duty of good faith and fair dealing? The answer of the Fifth and Ninth Circuits – that secretive, aggressive behavior is permissible so long as it does not explicitly breach a contractual term – is dangerous.

It is a matter of general knowledge that the nation is currently embroiled in a lingering economic crisis which originated in the market for mortgage-backed securities in New York's financial industry, roughly during the decade preceding the cataclysmic financial meltdown of 2008. Highland's dispute below with LifeCare and JPMorgan stems from one of thousands of financial transactions entered into during the period when the Wall Street bubble was being built on a mountain of bad faith conduct perpetrated by actors in the financial industry (such as Defendants below), most of which was governed by New York law (as in the case below), and all of which was embodied in contracts (as in the case below).

It is indisputable that the duty of good faith and fair dealing has a major effect on commercial and financial relations and economic growth. Commentators have even urged their states to adopt a

particular interpretation of the duty in order to encourage economic growth.[64]

At this precise moment in its history, the nation can scarcely afford to provide a blanket sanction to the type of aggressive, secretive behavior exemplified by LifeCare's actions, under the Fifth and Ninth Circuit's version of New York law. Neither can the nation afford the continued legal uncertainty fostered by having hundreds of "versions of state law" within our judicial system.

This outcome, in short, is precisely the opposite of what the nation needs as it struggles to emerge from a financial crisis that originated in New York's financial industry, whose economic relations are shepherded by the contractual duty of good faith and fair dealing.

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[64] *See, e.g.*, Erb, *The Implied Covenant of Good Faith and Fair Dealing in Alaska: One Court's License to Override Contractual Expectations*, 11 Alaska L. Rev. 35, 37 (1994).

CONCLUSION

For the reasons set forth above, the petition for a writ of *certiorari* should be granted on the questions presented.

Respectfully submitted,

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HIGHLAND CRUSADER OFFSHORE PARTNERS LP; HIGHLAND CREDIT STRATEGIES FUND; HIGHLAND DISTRESSED OPPORTUNITIES INC.; HIGHLAND FLOATING RATE ADVANTAGE FUND; HIGHLAND FLOATING RATE LLC; RESTORATION OPPORTUNITIES FUND; HIGHLAND CREDIT OPPORTUNITIES FUND CDO LP; HIGHLAND FUNDS I, on behalf of its Highland High Income Series, Plaintiffs-Appellants v. LIFECARE HOLDINGS INC.; LCI HOLDCO LLC; JP MORGAN CHASE BANK, NA, Defendants-Appellees

No. 09-10554

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

2010 U.S. App. LEXIS 9514

May 10, 2010, Filed

COUNSEL: For HIGHLAND CRUSADER OFFSHORE PARTNERS LP, HIGHLAND CREDIT STRATEGIES FUND, HIGHLAND DISTRESSED OPPORTUNITIES INC., HIGHLAND FLOATING RATE ADVANTAGE FUND, HIGHLAND FLOATING RATE LLC, RESTORATION OPPORTUNITIES FUND, HIGHLAND CREDIT OPPORTUNITIES FUND CDO LP, HIGHLAND FUNDS I, on behalf of its Highland High Income Series, Plaintiff-Appellants: Paul Brian Lackey, Scott Stuart Hershman, Ross Anthony Mortillaro, Lackey Hershman, L.L.P., Dallas, TX.

For LIFECARE HOLDINGS INC., LCI HOLDCO LLC, JP MORGAN CHASE BANK, NA, Defendants-Appellees. Charles Michael Moore, Gene R. Besen, Sonnenschein, Nath & Rosenthal, L.L.P., Dallas, TX; Drew W. Marrocco, Sonnenschein, Nath & Rosenthal, L.L.P., Washington, DC; Billy Beau Wells, III, Locke, Lord, Bissell & Liddell, L.L.P., Dallas TX.

JUDGES: Before DEMOSS, ELROD, and HAYNES, Circuit Judges.

OPINION

PER CURIAM:*

Highland[1] appeals the district court's dismissal of its contract claims and grant of summary judgment on its tort claims in favor of LifeCare Holdings, Inc., LCI Holdco, LLC (collectively, "LifeCare"), and JP Morgan Chase Bank, N.A. ("JP Morgan"). We AFFIRM.

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* Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

[1] Appellants include: Highland Crusader Offshore Partners LP; Highland Credit Strategies Fund; Highland Distressed Opportunities Inc; Highland Floating Rate Advantage Fund; Highland Floating Rate LLC; Restoration Opportunities Funds; Highland Credit Opportunities Fund CDO LP; Highland Funds I, on behalf of its Highland High Income Series, Highland Crusader Offshore. The Appellants will be collectively referred to as "Highland."

I. FACTS AND PROCEDURAL HISTORY

We recite the facts taking Highland's well-pleaded factual allegations as true and viewing the facts in the light most favorable to Highland. LifeCare is owned by The Carlyle Group, a private equity firm. Carlyle's original purchase of LifeCare was funded in part by a senior credit facility from a number of lenders, including Highland and JP Morgan, under a credit agreement dated August 11, 2005 (the "Credit Agreement"). Under the Credit Agreement, LifeCare was the borrower, Highland was a "Term B Lender," and JP Morgan was both a lender and LifeCare's administrative agent.[2] The Credit Agreement provided the terms by which LifeCare was to repay its debt, and § 9.02 of the Credit Agreement allowed for those terms to be amended. Under § 9.02, certain amendments could be made to the Credit Agreement if lenders holding more than 50% of the total loan commitment approved of the amendment. LifeCare utilized this provision to pass two amendments to the Credit Agreement, and the passage of the second amendment (the "Second Amendment") is the subject of this litigation.

As an inducement to consent to the Second Amendment, LifeCare offered an incentive payment

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[2] There are two types of lenders under the Credit Agreement: (1) lenders with revolving commitments under the Revolving Credit Facility; and (2) lenders with term loan commitments under the Term Loan B Facility ("Term B Lenders").

to all consenting Term B Lenders consisting of an amendment fee of 75 basis points (the "75 bps offer").[3] LifeCare's 75 bps offer was subject to two conditions: (1) LifeCare would only accept consents to the offer until the requisite vote was achieved; and (2) lenders consenting after that point would not be paid any amendment fees. LifeCare, through JP Morgan, posted the 75 bps offer in a secure digital workspace known as Intralinks, which only the lenders could access.[4]

A number of lenders, but not Highland, accepted LifeCare's 75 bps offer, bringing the total consenting to 47% (just shy of the 50% needed). Highland chose to monitor the offer's progress by collecting information on other lenders and tracking their positions on the proposal. On December 6, Highland, through its employee Mark Martinson, heard that LifeCare had increased its amendment fee offer to 125 bps to certain Term B Lenders. Martinson called Jackson Merchant at JP Morgan and questioned him about these higher offers. When Martinson asked Merchant directly whether other lenders were being offered 125 bps, Merchant stated that he could neither "confirm nor deny" that fact. Highland never consented.

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[3] "75 basis points" refers to LifeCare's offer of an amendment fee equal to 0.75% of the aggregate loan commitments of each lender.

[4] LifeCare also used Intralinks to disseminate information about the first amendment.

Thereafter, LifeCare announced that it had obtained the requisite number of consents and that the window to consent to the 75 bps offer had closed. LifeCare was able to obtain the requisite consents by offering an amendment fee of 125 bps to two Term B Lenders, Symphony Asset Management ("Symphony") and Quadrangle Group LLC ("Quadrangle").[5] LifeCare and JP Morgan did not disclose on Intralinks the 125 bps offers it made to Symphony and Quadrangle or their acceptance. After the requisite vote was achieved, LifeCare decided to pay all timely consenting lenders 125 bps, even though most of the lenders had consented at the 75 bps price. Because Highland never consented, it never received the inducement payment consisting of the amendment fees. This litigation ensued.

Highland initiated this lawsuit in Texas state court against LifeCare and JP Morgan, alleging that it was entitled to receive amendment fees because it would have consented to the Second Amendment if it had been offered 125 bps or became aware that other lenders were being offered 125 bps. Highland further alleged that LifeCare and JP Morgan's failure to disclose the 125 bps offers: (1) breached § 3.12 of the Credit Agreement; (2) breached the implied covenant

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[5] Symphony owned 2.3% of the loan commitments, and Quadrangle owned 4.4%. Their ownership percentages combined with the 47% that LifeCare had already obtained allowed LifeCare to obtain the votes it needed to pass the Second Amendment without Highland's consent.

of good faith and fair dealing under New York law; (3) constituted fraud; (4) constituted conspiracy to commit fraud; (5) constituted aiding and abetting fraud; and (6) constituted negligent misrepresentation.

JP Morgan and LifeCare removed Highland's suit to federal court and then moved to dismiss Highland's claims under Federal Rule of Civil Procedure ("Rule") 12(b)(6). The district court granted LifeCare's and JP Morgan's motion to dismiss in part and dismissed Highland's breach of contract, breach of the implied covenant of good faith and fair dealing, and aiding and abetting fraud claims. JP Morgan and LifeCare then moved for summary judgment on Highland's remaining claims, which the district court granted. This appeal followed.

II. DISCUSSION

Highland appeals[6] the district court's Rule 12(b)(6) dismissal of its breach of contract and breach of good faith and fair dealing claims.[7] Highland also appeals the district court's grant of summary

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[6] This court reviews de novo a district court's dismissal under Rule 12(b)(6) as well as a grant of summary judgment. *Beavers v. Metro. Life Ins. Co.*, 566 F.3d 436, 438-39 (5th Cir. 2009) (citing *Jones v. Alcoa, Inc.*, 339 F.3d 359, 362 (5th Cir. 2003)); *N. Am. Specialty Ins. Co. v. Royal Surplus Lines Ins. Co.*, 541 F.3d 552, 555 (5th Cir. 2008).

[7] Highland did not appeal the district court's dismissal of its aiding and abetting fraud claim. Accordingly, we do not consider it.

judgment on its fraud, conspiracy to commit fraud, and negligent misrepresentation claims.

A. Claims Dismissed Under Rule 12(b)(6)

Highland argues that the district court erred in dismissing its contract claims. Although this case invokes our federal question jurisdiction under 12 U.S.C. § 632, the parties do not challenge the district court's application of Texas's choice of law rules. The Credit Agreement contains an enforceable choice of law provision choosing New York law, and, because Texas would honor the agreement's choice of law provision, we find that New York law governs Highland's contract claims. *See Resolution Trust Corp. v. Northpark Joint Venture,* 958 F.2d 1313, 1318 (5th Cir. 1992) ("Under the Texas rules, in those contract cases in which the parties have agreed to an enforceable choice of law clause, the law of the chosen state must be applied."). Applying New York law, we affirm the district court's dismissal of Highland's contract claims.

1. Section 3.12 of the Credit Agreement

Section 3.12 contains the standard warranty that information furnished by each side in connection with the Credit Agreement was correct. Highland alleges that LifeCare and JP Morgan's failure to disclose the 125 bps offers breached § 3.12 because the failure to disclose rendered false or misleading their Intralinks offer of 75 bps. The district court rejected Highland's

contention, finding that the representation found in § 3.12 only warranted the accuracy of written information furnished in connection with the negotiation of the original Credit Agreement and its attendant loan documents. We review the district court's interpretation of § 3.12 de novo. *Duane Reade, Inc. v. Cardtronics, LP,* 54 A.D.3d 137, 863 N.Y.S.2d 14, 16 (N.Y. App. Div. 2008). In doing so, we must review the district court's interpretation of § 3.12 in light of the contract as a whole, *Bailey v. Fish & Neave,* 8 N.Y.3d 523, 868 N.E.2d 956, 959, 837 N.Y.S.2d 600 (N.Y. 2007), and, if the parties' intent with respect to § 3.12 can be discerned from evidence found within the four corners of the document, the court must enforce the parties' intent as written, *see W.W.W. Assocs., Inc. v. Giancontieri,* 77 N.Y.2d 157, 566 N.E.2d 639, 642, 565 N.Y.S.2d 440 (N.Y. 1990) ("[W]hen parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms."). Applying these standards, we find no error in the district court's interpretation.

The text of § 3.12 and the relevant definitions of its terms all support the district court's interpretation. The representation found in § 3.12 is written in the past tense and warrants the accuracy of certain identified documents and other written information furnished in connection with the negotiation of "this Agreement or any other Loan Document." The terms "this Agreement" and "Loan Document" are defined terms, and, when the original definitions of these terms are inserted into § 3.12, the section states, in

relevant part, that it only applies to "written information . . . furnished . . . in connection with the negotiation of the Credit Agreement dated as of August 11, 2005 . . . the Guaranties, the Assumption Agreement and the Security Documents."[8] Neither § 3.12 nor the original definitions of "this Agreement" or "Loan Documents" mentions amendments to the Credit Agreement, even though the parties clearly contemplated such amendments, as evidenced by § 9.02. Moreover, according to their definitions, "the Guaranties," "the Assumption Agreement," and "the Security Documents" were all documents that were attached as exhibits to the Credit Agreement on August 11, 2005, a fact that further supports the district court's interpretation. We find no basis to reverse on this claim.

2. Covenant of good faith and fair dealing

Highland also alleges that the manner in which LifeCare and JP Morgan negotiated the Second Amendment breached the Credit Agreement's implied covenant of good faith and fair dealing. Under New York law, every contract contains an "[i]mplied . . .

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[8] Highland argues that the first and second amendments' redefinition of the term "this Agreement" to mean "the Credit Agreement, as amended by this Amendment," shows that the parties intended § 3.12 to apply to amendments to the Credit Agreement. While amendments to the Credit Agreement do become part of the agreement itself, this redefinition of the term "this Agreement," in light of the evidence above, does not show that the parties intended § 3.12 to apply to amendments.

covenant of good faith and fair dealing, which is breached when a party to a contract acts in a manner that, although not expressly forbidden by any contractual provision, would deprive the other party of the right to receive the benefits [it contracted for] under their agreement." *Jaffe v. Paramount Commc'ns, Inc.*, 222 A.D.2d 17, 644 N.Y.S.2d 43, 47 (N.Y. App. Div. 1996) (citation omitted); *see Maddaloni Jewelers, Inc. v. Rolex Watch U.S.A., Inc.*, 41 A.D.3d 269, 838 N.Y.S.2d 536, 538 (N.Y. App. Div. 2007); *see also Dalton ex rel. Dalton v. Educ. Testing Serv.*, 87 N.Y.2d 384, 663 N.E.2d 289, 291, 639 N.Y.S.2d 977 (N.Y. 1995). Highland alleges that LifeCare and JP Morgan's actions deprived it of the opportunity to be compensated for amendments to the Credit Agreement. The Credit Agreement, however, expressly allows amendments such as this one to be made without all parties consenting and further does not provide that each consenting party must be the subject of equal inducements to consent. Highland's argument would result not in a "fair play" standard being applied but rather a wholesale rewriting of the contract to grant it a benefit for which it did not bargain.[9] Because Highland has failed to plead that

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[9] For this same reason, Highland's arguments regarding course of dealing and industry custom fail. Highland argues that the Credit Agreement is "silent" as to whether LifeCare and JP Morgan had to give notice of the 125 bps offer on Intralinks and, therefore, the district court had to consider extrinsic evidence allegedly showing that such notice was required. Under New York law, a court may "not imply a term where the circumstances surrounding the formation of the contract indicate that the

(Continued on following page)

LifeCare's and JP Morgan's actions deprived it of any benefit that it bargained for in the Credit Agreement, we find that the district court properly dismissed Highland's good faith claim. *See Jaffe,* 644 N.Y.S.2d at 47-48 (finding that a plaintiff's good faith claim was properly dismissed because "plaintiff failed to allege any facts to demonstrate that [the defendant] deprived him of any rights he had under the Agreement").

B. Claims Disposed of on Summary Judgment

Highland also appeals the district court's grant of summary judgment on its fraud, negligent misrepresentation, and conspiracy to commit fraud claims. As stated earlier, Texas's choice of law rules apply to this case, and, after applying those rules, we find that Texas law governs the extracontractual claims. Under Texas law, we find that the district court properly granted summary judgment on Highland's fraud, negligent misrepresentation, and conspiracy to commit fraud claims.

1. Fraud and Negligent Misrepresentation

Highland claims that LifeCare and JP Morgan are liable for fraud and negligent misrepresentation

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parties, when the contract was made, must have foreseen the contingency at issue and the agreement can be enforced according to its terms." *Reiss v. Fin. Performance Corp.,* 97 N.Y.2d 195, 764 N.E.2d 958, 961, 738 N.Y.S.2d 658 (N.Y. 2001).

for representing that all Term B lenders were being offered 75 bps when in reality some lenders were being offered 125 bps. Highland further alleges that it justifiably relied on LifeCare and JP Morgan's false or misleading representation in deciding not to consent to the 75 bps offer. Justifiable or reasonable reliance is an element of both fraud and negligent misrepresentation. *See Richter v. Wagner Oil Co.*, 90 S.W.3d 890, 896-97 (Tex. App.-San Antonio 2002, no pet.) (stating that if a party knows that a representation is false before acting upon it, he cannot reasonably rely on the misrepresentation and has no claim for fraud or negligent misrepresentation); *see also Clardy Mfg. Co. v. Marine Midland Bus. Loans Inc.*, 88 F.3d 347, 358 (5th Cir. 1996) ("[U]nder a claim for negligent misrepresentation, the plaintiff must prove 'justifiable reliance' on the misrepresentation."); *Ernst & Young, L.L.P. v. Pac. Mut. Life Ins. Co.*, 51 S.W.3d 573, 577 (Tex. 2001) ("To prevail on its fraud claim, [a plaintiff] must prove that: . . . (4) [it] actually and justifiably relied upon the representation. . . .").

The undisputed summary judgement evidence shows that Highland collected information on other lenders and learned that LifeCare and JP Morgan had made offers of 125 bps to other lenders before the window for accepting the 75 bps offer closed. In the trial court, Highland stipulated that one of its employees, Martinson, actively "collected and updated . . . information he obtained on other Lenders' positions regarding the proposed second amendment in an electronic tracking sheet." Martinson testified

during his deposition that he learned of the 125 bps offers and questioned JP Morgan about the offers when Highland still had an opportunity to accept the 75 bps offer. Martinson further testified that, when he asked JP Morgan directly about the 125 bps offers, JP Morgan stated that they could neither confirm nor deny whether such offers were made.

Based on Highland's own stipulation and the undisputed testimony of Martinson, no reasonable jury could find that Highland justifiably relied on LifeCare and JP Morgan's alleged misrepresentation because its own investigation of the facts negated any reasonable reliance upon the supposed misrepresentations. *See Camden Mach. & Tool, Inc. v. Cascade Co.*, 870 S.W.2d 304, 311 (Tex. App.-Fort Worth 1993, no writ) ("[W]hen a person makes his own investigation of the facts, and knows the representations are false, he cannot, as a matter of law, be said to have relied upon the misrepresentations of another."). Accordingly, we find that the district court properly granted summary judgment on Highland's fraud and negligent misrepresentation claims.

2. Conspiracy to Commit Fraud

Highland's conspiracy claim is derivative of its fraud claim. *Tilton v. Marshall*, 925 S.W.2d 672, 681 (Tex. 1996). Because we find that summary judgment was properly granted as to Highland's fraud claim, we find that summary judgment was also properly granted as to Highland's conspiracy claim. *See Cmty.*

Initiatives, Inc. v. Chase Bank of Tex., 153 S.W.3d 270, 285 (Tex. App.-El Paso 2004, no pet.) ("[I]f [a] plaintiff fails to raise a fact question as to the liability of at least one of the defendants for an underlying tort, it is proper to render a summary judgment against the plaintiff on a civil conspiracy claim.").

III. CONCLUSION

For the foregoing reasons, we AFFIRM.

HIGHLAND CRUSADER OFFSHORE PARTNERS, L.P., et al., Plaintiffs, v. LIFECARE HOLDINGS, INC., et al., Defendants

CIVIL ACTION NO. 3:08-CV-0102-B

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS, DALLAS DIVISION

2008 U.S. Dist. LEXIS 66229

August 27, 2008, Decided
August 27, 2008, Filed

COUNSEL: For Highland Crusader Offshore Partners LP, Highland Credit Strategies Fund, Highland Distressed Opportunities Inc, Highland Floating Rate Advantage Fund, Highland Floating Rate LLC, Highland Credit Opportunities Fund CDO LP, Highland Funds I, on behalf of its Highland High Income Series, Plaintiffs: Paul B Lackey, LEAD ATTORNEY, Jamie R Welton, Scott M Garelick, Lackey Hershman, Dallas, TX.

For Restoration Opportunities Fund, Plaintiff: Paul B Lackey, LEAD ATTORNEY, Jamie R Welton, Lackey Hershman, Dallas, TX.

For LifeCare Holdings Inc, LCI Holdco LLC, JP Morgan Chase Bank NA, Defendants: Charles Michael Moore, LEAD ATTORNEY, Gene R Besen, Sonnenschein Nath & Rosenthal LLP, Dallas, TX; Drew W Marrocco, Sonnenschein Nath & Rosenthal LLP, Washington, DC.

Jonathan Lee Riches, Movant, Pro se, Salters, SC.

For ADR Provider, Mediator: Christopher Marc Nolland, LEAD ATTORNEY, Law Office of Christopher Nolland, Dallas, TX.

JUDGES: JANE J. BOYLE, UNITED STATES DISTRICT JUDGE.

OPINION BY: JANE J. BOYLE

OPINION

MEMORANDUM ORDER

Before the Court is Defendants' Motion to Dismiss Plaintiffs' Complaint pursuant to Federal Rule of Civil Procedure 12(b)(6). (doc. 15). For the reasons that follow, the Court **GRANTS** the Motion to Dismiss the Plaintiffs' breach of contract, breach of the duty of good faith and fair dealing, and aiding and abetting fraud claims and **DENIES** the Motion to Dismiss the Plaintiffs' fraud, negligent misrepresentation, and conspiracy to commit fraud claims.

I. Background

Defendant LifeCare Holdings, Inc. ("LifeCare"), which operates acute care hospitals in several states, is owned and operated by The Carlyle Group, a global private equity firm. (Pls.' Original Pet. ("Pet.") 5-6). On August 11, 2005, Rainier Acquisition Corp. purchased LifeCare for $552 million. (*Id.* at 6). Related to this transaction, LifeCare borrowed $255 million

under a senior credit facility. (*Id.*). A Credit Agreement ("Credit Agreement") dated August 11, 2005 sets out the terms of this senior credit facility. (*Id.*). The parties to this Credit Agreement are (1) the Defendant borrowers consisting of LifeCare and LCI Holdco, LLC ("LCI"); (2) the lenders consisting of, among others, the Plaintiffs[1] in this action; and (3) Defendant JPMorgan Chase Bank, N.A. ("JPMorgan"), which is the administrative and collateral agent and also a lender. (*Id.*). At the time of the transaction at issue, the Plaintiffs owned approximately 53.8% of the outstanding term loans. (*Id.* at 6).

In April 2007, LifeCare sought to amend the Credit Agreement. (*Id.* at 7). A draft of the first amendment of the Credit Agreement was sent to all of the lenders via a secure digital workspace known as "Intralinks." (*Id.*). All of the written proposals with respect to the first amendment were exchanged between LifeCare, JPMorgan, and all of the lenders through Intralinks. (*Id.*). According to the Plaintiffs, "virtually all amendments to a credit agreement

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[1] The Plaintiff lenders in this transaction consist of Highland Crusader Offshore Partners, L.P.; Highland Credit Strategies Funds; Highland Distressed Opportunities, Inc.; Highland Floating Rate Advantage Fund; Restoration Opportunities Funds; Highland Credit Opportunities Fund CDO, L.P.; and Highland Funds I. (Pls.' Pet. 3). These parties will collectively be referred to as the Plaintiffs. Defendants LifeCare Holdings, Inc.; LCI Holdco, LLC; and JPMorgan Chase Bank, N.A. will collectively be referred to as the Defendants.

include an amendment fee to be paid by the borrower to the consenting lenders." (*Id.*). The first amendment provided that the borrower would pay each Lender that executed the amendment by April 30, 2007 an amendment fee equal to "0.25% of the aggregate Revolving Commitments and Term Loan Commitments of each such lender." (*Id.* at 8). Under the Credit Agreement, lenders "representing more than 50% of the sum of the total Revolving Exposures, outstanding Term Loans and unused Commitments" were required to consent to the amendment before it became effective. (*Id.*). The Plaintiffs and other lenders consented to the first amendment and received their amendment fees. (*Id.*).

In November 2007, all of the lenders were invited to participate in a conference call to discuss a second proposed amendment of the Credit Agreement. (*Id.*). Materials related to this conference call were circulated on Intralinks. (*Id.*). The proposed amendment sought to "increase the interest coverage and net leverage ratios on the Revolver and Term Loans and to increase Carlyle's existing equity rights to cure certain defaults or covenant breaches by the Borrowers." (*Id.* at 9). In return, the borrowers proposed an increase in the initial pricing on the Revolver and Term Loan positions by 50 basis points ("bps"). In addition, each consenting lender would receive an amendment fee of 25 bps of the aggregate Revolving Commitments and Term Loan Commitments of each such lender. (*Id.*). The Plaintiffs did not consent to this amendment. (*Id.*).

On December 5, 2007, JPMorgan circulated a revised proposal and posted it on Intralinks. (*Id.* at 9). This revised proposal offered an enhancement from 50 bps to 100 bps in the increase in the initial price and an increase in the amendment fee from 25 bps to 75 bps. (*Id.*). Instead of offering this amendment fee to all consenting lenders who consented to the amendment by a certain date, the proposal stated, the "Company will be accepting consent signature pages **until the required >50% vote is achieved and subsequent consents will not be accepted nor will amendment fees be paid**." (*Id.* at 10 (emphasis in original)). The Plaintiffs did not consent to this revised proposal. (*Id.*). The Defendants offered an enhanced amendment fee of 125 bps to some of the lenders but did not include the Plaintiffs in this offer. (*Id.*). This offer was never posted on Intralinks. (*Id.*). The proposed amendment received the requisite 50% lender approval and the consenting lenders were paid 125 bps. (*Id.* at 11). The Plaintiffs claim that if they had been aware of the enhanced amendment fee, they would have immediately approved it and that if they had been aware that the other lenders were offered the enhanced amendment fee, they would have immediately approved the amendment at 75 bps. (*Id.*). The CEO and CFO of LifeCare confirmed that LifeCare had knowingly and intentionally not provided the enhanced amendment fee offer to the Plaintiffs. (*Id.*).

On December 21, 2007, based on these allegations, the Plaintiffs filed this action in the 191st Judicial

District Court of Dallas County, Texas alleging breach of contract (the Credit Agreement), breach of the duty of good faith and fair dealing, fraud, negligent misrepresentation, aiding and abetting fraud, and conspiracy to commit fraud. (*Id.* at 12-17). They claim they are entitled to 125 bps on $134,539,351.79 in outstanding Term Loans ($1,681,741.90) plus attorneys fees and costs, prejudgment interest, and exemplary and punitive damages. (*Id.* at 12). On January 22, 2008, Defendant JPMorgan filed a notice of removal, and on May 15, 2008, this Court denied the Plaintiffs' Motion to Remand. (doc. 20). The Defendants filed their Motion to Dismiss on April 9, 2008 (doc. 15). The Plaintiffs filed a Response on May 9, 2008[2] (doc. 19), and the Defendants filed their Reply on May 27, 2008 (doc. 23). The Motion to Dismiss is thus ripe for disposition.

II. Analysis

A. Legal Standard

In analyzing a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim, the Court accepts all well-pleaded facts as true, viewing them in the light most favorable to the plaintiff. *Martin K. Eby Constr. Co. v. Dallas Area Rapid Transit,* 369 F.3d 464, 467 (5th Cir. 2004). Motions to dismiss under Rule 12(b)(6) are viewed

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[2] The Court granted the Defendants an extension of time to file their Response (doc. 18).

with disfavor and are rarely granted. *Priester v. Lowndes County*, 354 F.3d 414, 418 (5th Cir. 2004). A 12(b)(6) motion to dismiss should be granted only if the complaint does not include "enough facts to state a claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 444, 127 S. Ct. 1955, 1974, 167 L. Ed. 2d 929 (2007). The Court's review is limited to the allegations in the complaint and to those documents attached to a defendant's motion to dismiss to the extent that those documents are referred to in the complaint and are central to the claims. *Causey v. Sewell Cadillac-Chevrolet, Inc.*, 394 F.3d 285, 288 (5th Cir. 2004).

B. Choice of Law

In deciding on the law to apply with respect to the parties' state-based claims, the Court applies the choice-of-law rules of the forum state, here being Texas. *Mayo v. Hartford Life Ins. Co.*, 354 F.3d 400, 403 (5th Cir. 2004). The parties appear to agree that New York law should govern the Plaintiffs' breach of contract and breach of the duty of good faith and fair dealing claims and that Texas law should govern the Plaintiffs' fraud, negligent misrepresentation, aiding and abetting fraud, and conspiracy to commit fraud claims. (Mot. to Dismiss ("Mot.") 9 n.3, 19 & n.7; Resp. 6, 19). Under Texas law, if the parties have agreed to an enforceable choice of law clause, the court will apply the law of that state to contract claims. *Resolution Trust Corp. v. Northpark Joint Venture*, 958 F.2d 1313, 1318 (5th Cir. 1992). Section

9.09 of the Credit Agreement[3] provides, "This Agreement shall be construed in accordance with and governed by the law of the State of New York." (Defs.' App. 128). Accordingly, the Court agrees with the parties that New York law governs the breach of contract and breach of the duty of good faith and fair dealing claims.

The Court will consider the following factors when applying choice of law principles to tort cases: "(a) the place where the injury occurred, (b) the place where the conduct causing the injury occurred, (c) the domicil[e], residence, nationality, place of incorporation and place of business of the parties, and (d) the place where the relationship, if any, between the parties is centered." *Hughes Wood Prods., Inc. v. Wagner,* 18 S.W.3d 202, 205 (Tex. 2000) (citing *RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145(2)* (1971); *Gutierrez v. Collins,* 583 S.W.2d 312, 318-19 (Tex. 1979)). According to the Plaintiffs' petition, and undisputed by the Defendants, "all or substantially all of the events giving rise to this litigation occurred in Dallas County, Texas." (Pet. ¶ 16; Mot. 19). In addition, many of the Plaintiffs as well as Defendants LifeCare and LCI have their principal places of business in Texas. (Pet. ¶¶ 3-9, 12-13). Therefore, the Court agrees that Texas law shall

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[3] The Court may consider the Credit Agreement provided in the Appendix to the Defendants' Motion to Dismiss because it is referred to in the Plaintiff's petition and is central to the Plaintiffs' claims. *Causey,* 394 F.3d at 288.

apply to the fraud, negligent misrepresentation, aiding and abetting fraud, and conspiracy to commit fraud claims. Having determined the choice of law, the Court will now turn to the Defendants' arguments in support of their Motion to Dismiss the breach of contract and duty of good faith and fair dealing claims.

C. Breach of Contract and Duty of Good Faith and Fair Dealing

The Plaintiffs' breach of contract claims include (1) failing "to give Plaintiffs notice of the Enhanced Agreement Fee as required by § 9.01 of the Credit Agreement;" (2) furnishing "information to Plaintiffs in connection with the negotiation of Amendment No. 2 to the Credit Agreement that was misleading" in violation of Section 3.12 of the Credit Agreement; and (3) breach of "their equitable covenants to deal with Plaintiffs, as Lenders, fairly and in a manner that is consistent with the standard industry practice and course of dealing between the parties" in violation of Section 3.02 of the Credit Agreement. (Pet. ¶¶ 43-45). The Defendants move to dismiss these claims because (1) the Plaintiffs have failed to identify any express contract provisions that the Defendants have breached; (2) the contract is unambiguous; and (3) the Plaintiffs may not use custom and usage or industry practice to alter/amend this unambiguous contract. (Mot. 10-14). The Court will begin with the contract claims with respect to Sections 9.01 and 3.12 of the Credit Agreement. A review of the language of these

provisions makes it clear that the Defendants have not breached these provisions.

1. Section 9.01

Section 9.01 (a) provides:

> Except in the case of notices and other communications expressly permitted to be given by telephone, all notices and other communications *provided for herein* shall be in writing and shall be delivered by hand or overnight courier service, mailed by certified or registered mail or sent by telecopy, as follows . . .

(Defs.' App. 118) (emphasis added). According to the Plaintiffs, this provision required the Defendants to give them notice of the enhanced amendment fee and failure to do so constituted a breach. However, as the Defendants point out, this provision applies to notices provided for by the Credit Agreement. (Reply 3). The Plaintiffs do not point to any provision in the Credit Agreement that requires notice of offers of amendment fees or of negotiations of amendments between the borrowers and lenders. The Defendants have not failed to give any notice that is required by the Credit Agreement; therefore, the Plaintiffs' claim for breach of Section 9.01 should be dismissed. The Plaintiffs' statement that section 9.02 requires actual amendments to the Credit Agreement (as opposed to offers or negotiations regarding amendments to the Credit Agreement) to be in writing does not save the Plaintiffs' claim. (Resp. 4). The Defendants' Motion to

Dismiss the Plaintiffs' claim for breach of Section 9.01 is **GRANTED**.

2. Section 3.12

The Plaintiffs' claim that the Defendants breached Section 3.12 likewise fails. Section 3.12 provides:

> Neither the Information Memorandum nor any of the other written reports, financial statements, certificates or other written information, taken as a whole, furnished by or on behalf of any Loan Party to the Administrative Agent or any Lender *in connection with the negotiation of this Agreement or any other Loan Document* or delivered hereunder or thereunder (as of the date thereof and as modified or supplemented by other information so furnished) contains any material misstatement of fact or omits to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; provided that, with respect to information of a general economic nature, estimates and projected financial information, Holdings and the Borrower represent only that such information was prepared in good faith based upon assumptions believed to be reasonable (I) at the time such projected financial information was prepared, (ii) on the date of the Information Memorandum and (iii) as of the date hereof (it being understood

> that actual results may vary materially from such projected financial information).

(Defs.' App. 77 (emphasis added)).

The Plaintiffs claim that the Defendants furnished "information to Plaintiffs in connection with the negotiation of Amendment No. 2 to the Credit Agreement that was misleading." (Pet. ¶ 45). Section 3.12 applies to information in connection with "the negotiation of this Agreement or any other loan document," not negotiation of *amendments* to the Credit Agreement. Loan document is defined as "this Agreement, the Guaranties, the Assumption Agreement and the Security Documents." (Defs.' App. 31). Even assuming that the Defendants furnished misleading information, this misleading information was furnished in connection with the negotiation of the amendment of the Agreement and not the Agreement itself or other loan documents. Accordingly, the Defendants' Motion to Dismiss the Plaintiffs' claim for breach of Section 3.12 is **GRANTED**.

3. Section 3.02/Breach of Implied Covenant of Good Faith and Fair Dealing

Finally, the Plaintiffs claim that the Defendants breached Section 3.02. The Court begins by noting, as pointed out by the Defendants, that the Plaintiffs' quotation of Section 3.02 omits a significant portion of the provision and is rather misleading. (Reply 2). The Plaintiffs' quotation is "[t]ransactions entered into and to be entered into by each Loan Party are . . .

subject to general principles of equity, regardless of whether considered in a proceeding at equity or at law, and implied covenants of good faith and fair dealing." (Resp. 6). The entire provision provides:

> The Transactions entered into and to be entered into by each Loan Party are within such Loan Party's corporate, limited partnership or limited liability company powers, as applicable, and have been duly authorized by all necessary corporate, limited partnership or limited liability company and, if required, stockholder action. This Agreement has been duly executed and delivered by each of Holdings and the Borrower and constitutes, and each other Loan Document to which any Loan Party is to be a party, when executed and delivered by such Loan Party, will constitute, a legal, valid and binding obligation of Holdings, the Borrower or such Loan party (as the case may be), enforceable in accordance with its terms, subject to applicable bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance or other laws affecting creditors' rights generally and subject to general principles of equity, regardless of whether considered in a proceeding at equity or at law, and implied covenants of good faith and fair dealing.

(Defs.' App. 72). The duty of good faith and fair dealing applies to the Agreement, not as the Plaintiffs claim, to the "transactions entered into and to be entered into by each Loan Party." This provision incorporates the implied covenant of good faith and

fair dealing. The analysis would be the same whether the Court considers this claim as breach of an express provision of the contract (Section 3.02) or as a breach of the implied covenant of good faith and fair dealing; therefore, the Court will consider these claims together.

In their petition, the Plaintiffs allege, "Defendants breached the express and implied covenant of good faith and fair dealing in the Credit Agreement. Defendants acted in a manner that had the effect of destroying or injuring the right of Plaintiffs to receive the amendment fee with respect to the Second Amendment." (Pet. ¶ 50). The Defendants move to dismiss the breach of the implied covenant of good faith and fair dealing because (1) no provision of the contract, when read together with the covenant, "imposes an affirmative obligation on defendants which they have breached;" (2) the covenant cannot add a substantive provision not included in the contract; and (3) the covenant does not apply to amendments or future conduct (Mot. 15-19).

Under New York law, the implied covenant of good faith and fair dealing provides that "'neither party to a contract shall do anything which has the effect of destroying or injuring the right of the other party to receive the fruits of the contract.'" *Thyroff v. Nationwide Mut. Ins. Co.*, 460 F.3d 400, 407 (2d Cir. 2006) (quoting *M/A-COM Sec. Corp. v. Galesi*, 904 F.2d 134, 136 (2d Cir. 1990)). "'[T]his covenant only applies where an implied promise is so interwoven into the contract 'as to be necessary for effectuation of

the purposes of the contract.' For this to occur, a party's action must directly violate 'an obligation that may be presumed to have been intended by the parties.' However, 'the implied covenant does not extend so far as to undermine a party's general right to act on its own interests in a way that may incidentally lessen the other party's anticipated fruits from the contract.'" *Id.* at 407-08 (quoting *Galesi,* 904 F.2d at 136). The covenant may only be invoked when a party has "violated the spirit, although not the letter, of a contract." *Harris Trust & Sav. Bank v. E-II Holdings, Inc.,* 926 F.2d 636, 642 (7th Cir. 1991) (citation omitted). The test is whether the Plaintiffs are seeking to enforce "'promises which a reasonable person in the position of the [Plaintiffs] would be justified in understanding were included [in the Credit Agreement].'" *Id.* at 643 (quoting *Havel v. Kelsey-Hayes Co.,* 83 A.D.2d 380, 445 N.Y.S.2d 333 (N.Y. App. Div. 1981)) (other citation omitted).

The Court agrees with the Defendants' second argument that the implied covenant cannot create a new or inconsistent obligation and finds dismissal appropriate on that ground. The covenant "is implied only where the implied term 'is consistent with other mutually agreed upon terms in the contract.' In other words, the implied covenant will only aid and further the explicit terms of the agreement and will never impose an obligation "which would be inconsistent with other terms of the contractual relationship."" *Metro. Life Ins. Co. v. RJR Nabisco, Inc.,* 716 F. Supp. 1504, 1517 (S.D.N.Y. 1989) (quoting *Sabetay*

v. Sterling Drug, Inc., 69 N.Y.2d 329, 506 N.E.2d 919, 922, 514 N.Y.S.2d 209 (N.Y. 1987)). In their petition, the Plaintiffs allege that the Defendants' actions destroyed their right to receive an amendment fee. However, the Credit Agreement does not provide for this right. Plaintiffs are attempting to use the implied covenant to create a right to an amendment fee or an obligation on the part of the Defendants to negotiate with or notify all of the lenders of offers of amendment fees. Section 9.02 of the Credit Agreement explicitly addresses how it may be amended and only requires consent of a percentage of the lenders:

> [N]either this Agreement nor any other Loan Document nor any provision hereof or thereof may be waived, amended or modified except, in the case of this Agreement, pursuant to an agreement or agreements in writing entered into by Holdings, the Borrower and the Required Lenders . . . *provided* that no such agreement shall . . . [lists restrictions].

(Defs.' App. 119). "Required Lenders" is a defined term meaning, "at any time, Lenders having Revolving Exposures, Term Loans and unused Commitments representing more than 50% of the sum of the total Revolving Exposures, outstanding Term Loans and unused Commitments at such time." (*Id.* at 41). Thus, the Credit Agreement explicitly allows the Defendants to amend it by obtaining the consent of the required percentage of lenders, provided that the amendment does not violate one of the restrictions.

Notably, the Plaintiffs have not claimed a breach of Section 9.02.

Requiring notifications to or negotiations with all of the lenders would be adding a term that is inconsistent with this unambiguous contract. As the Defendants claim, the Credit Agreement allows them to deal with less than all of the lenders when amending the Credit Agreement. (Mot. 12-13). Requiring notice to or negotiation with all of the lenders would write this benefit out of the contract. (*Id.*). That the Credit Agreement does not explicitly state that notice/negotiation is not required does not save this claim. *Metro. Life,* 716 F. Supp. at 1519 ("Although the indentures generally permit mergers and the incurrence of new debt, there admittedly is not an explicit indenture provision to the contrary of what plaintiffs now claim the implied covenant requires. That absence, however, does *not* mean that the Court should imply into those very same indentures a covenant of good faith so broad that it imposes a new, substantive term of enormous scope."). The presence of an integration clause[4] in the Credit Agreement and the sophistication of the parties further supports the Defendants' arguments. *Id.* at 1522 ("[C]ourts are properly reluctant to imply into an integrated

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[4] Section 9.06 provides, "This Agreement . . . constitute the entire contract among the parties relating to the subject matter hereof and supersede any and all previous agreements and understandings, oral or written, relating to the subject matter hereof." (Defs.' App. 128).

agreement terms that have been and remain subject to specific, explicit provisions, where the parties are sophisticated investors, well versed in the market's assumptions, and do not stand in a fiduciary relationship with one another.").

The Court finds two recent cases particularly instructive. *In re Musicland Holding Corp.*, involved, among other claims, breach of contract and breach of the covenant of good faith and fair dealing claims with respect to an Intercreditor Agreement. 386 B.R. 428, 434 (S.D.N.Y. 2008). At issue was whether the Intercreditor Agreement authorized an amendment to the Revolving Credit Agreement to bring in a term lender. *Id.* at 434. The Intercreditor Agreement defined "Revolving Credit Agreement" as the original loan documents as they now existed or may be amended or modified. *Id.* at 432. This definition placed a restriction on the ability to amend in that the debtor's affiliates could not be made lenders. *Id.* at 432, 435. The agreement also stated that the creditors waived notice and consented to amendments of the Revolving Creditor Agreement. *Id.* at 433, 435. The plaintiffs claimed that their expectation was that the Revolving Credit Agreement would only be amended for routine matters. *Id.* at 437. The court found that under New York law, the Intercreditor Agreement unambiguously allowed the amendment:

> While Appellants could have, and perhaps should have included language specifically restricting Wachovia's ability to incorporate a term loan into the Revolving Credit

> Agreement by amendment, "courts may not by construction add or excise terms, nor distort the meaning of those used and thereby make a new contract for the parties under the guise of interpreting the writing."

Id. at 438 (quoting *Reiss v. Fin. Performance Corp.*, 97 N.Y.2d 195, 764 N.E.2d 958, 738 N.Y.S.2d 658 (N.Y.2001)). The Court later stated, "The Intercreditor Agreement did, in fact, place a limitation on Wachovia's ability to amend the Intercreditor Agreement, indicating that the parties knew how to restrict Wachovia's ability to amend if they so desired." *Id.*

The Court went on to consider the breach of the duty of good faith and fair dealing and explained, "The duty of good faith and fair dealing is a tool of interpretation that cannot be used to rewrite a contract and impose new terms." *Id.* (citing *Metro. Life*, 716 F. Supp. at 1519). The Court recognized that the covenant may be used to fill gaps when a contract is silent. *Id.* at 439. However, the district court concluded that the Intercreditor Agreement was not silent because it permitted amendments to the Revolving Creditor Agreement and affirmed the bankruptcy court's dismissal of the claim for breach of contract and the covenant of good faith and fair dealing. *Id.* at 438-39.

In *Oppman*, the plaintiff shareholders entered a Stock Purchase Agreement and became parties to the Amended and Restated Stockholders' Agreement among the defendant and its shareholders. *Oppman v. IRMC Holdings, Inc.*, 14 Misc. 3d 1219A, 836

N.Y.S.2d 494, 2007 NY Slip Op 50093U *1 (N.Y. Sup. Ct. 2007). The plaintiffs alleged that some of the defendants recommended a recapitalization plan to some of the shareholders, which was adopted by written shareholder consent. 14 Misc. 3d 1219A, 836 N.Y.S.2d 494, 2007 NY Slip Op 50093U at *2. To effect this plan, the defendants obtained written consent to amend the Certificate of Incorporation to allow conversion of Old Series A Preferred Stock. *Id.* The amendment provided that holders of the stock who did not participate in the refinancing would have each share of their preferred stock converted into a share of Class A Common Stock. *Id.* The defendants then filed Certificates of Amendment with the Delaware Secretary of State stating that the majority consented to certain resolutions. *Id.* These resolutions set a conversion date for stockholders not participating in the refinancing, provided for automatic conversion for the non-participating stockholders, and stated that the non-participating stockholders would be given notice of the mandatory conversion (but specified that notice need not be given prior to conversion). *Id.* They also stated that non-participating stockholders would forfeit any right to receive a liquidation preference. *Id.* The plaintiffs claimed that they were not provided with the amendments until after the forfeitures of their holdings had occurred. 14 Misc. 3d 1219A, 836 N.Y.S.2d 494, 2007 NY Slip Op 50093U at *3. Among other claims, the plaintiffs brought a claim for the implied covenant of good faith and fair dealing. 14 Misc. 3d 1219A, 836 N.Y.S.2d 494, 2007 NY Slip Op 50093U at *5. The court found

that the plaintiffs' rights as stockholders were governed by the Stockholder's Agreement, the Certificate of Incorporation, and By-Laws. *Id.* The Certificate of Incorporation expressly allowed the corporation to authorize shares senior to Old Series A Preferred shares if it obtained the consent of a majority of the shareholders of the Old Series A Preferred stock. *Id.* The Bylaws allowed the Board of Directors to dispose of a stockholder meeting and notice thereof and a vote of stockholders when taking action by written consent. *Id.* In compliance with this, the defendants obtained the majority written consent. *Id.* The court, stating that the implied covenant would not be used to create an obligation inconsistent with the contract, refused to imply a covenant of good faith and fair dealing. *Id.* The agreement specified how preferred stock would be issued and did not require notice to the current preferred stockholders. *Id.*

Like the agreement in *Musicland*, the Credit Agreement at issue unambiguously allowed the Defendants to amend the Credit Agreement. That the Credit Agreement required the consent of the required lenders and placed restrictions on the type of amendments indicates that the parties knew how to place restrictions on the ability to amend. However, they did not place any restrictions on the procedure for obtaining the consent of the required number of lenders. Adding the requirement that all lenders be notified of the offer of an amendment fee would add a new term to the contract. As in *Musicland*, the Court rejects the Plaintiffs' argument that the implied

covenant fills in gaps for the procedure for soliciting amendments to the Credit Agreement because here the Credit Agreement was not silent on the issue of amendments.

Similar to *Oppman,* the Credit Agreement provided for amendments by majority consent. The Court will not impose an implied covenant requiring negotiation and notice when the Credit Agreement did not require it. The Court concludes that the Plaintiffs "do not invoke an implied covenant of good faith to protect a legitimate, mutually contemplated benefit of the [Credit Agreement]; rather, they seek to have this Court create an additional benefit for which they did not bargain." *Metro. Life,* 716 F.Supp. at 1519. Because the Court agrees with the Defendants' second argument for dismissal of the implied covenant claim, the Court need not consider the Defendants' other arguments regarding the duty of good faith and fair dealing.

4. Evidence of Usage or Industry Practice

Much of the Plaintiffs' Response relies on prior course of dealing and industry custom and practice. (Resp. 10-14). The Plaintiffs claim that when soliciting proposed amendments, the Defendants had generally adhered to the "Procedures for Credit Agreement Modifications" issued by the Loan Syndications and Trading Association, Inc., which required them to notify each lender of pending modifications and furnish each lender with the proposed form of

modification in advance of the deadline for consent. (*Id.* at. 8). The Court need not consider this extrinsic evidence because the Credit Agreement is unambiguous. "A familiar and eminently sensible proposition of law is that, when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissable to add to or vary the writing." *W.W.W. Assocs., Inc. v. Giancontieri,* 77 N.Y.2d 157, 566 N.E.2d 639, 642, 565 N.Y.S.2d 440 (N.Y. 1990) (citations omitted). When a contract is unambiguous, the Court will not consider parol evidence. *767 Third Ave LLC v. Orix Capital Markets, LLC,* 26 A.D.3d 216, 812 N.Y.S.2d 8, 10 (N.Y. App. Div. 2006). "[A]mbiguity does not arise from silence, but from 'what was written so blindly and imperfectly that its meaning is doubtful.'" *Nissho Iwai Europe PLC v. Korea First Bank,* 99 N.Y.2d 115, 782 N.E.2d 55, 60, 752 N.Y.S.2d 259 (N.Y. 2002).

For example, in *767 Third,* the court determined that the loan document, which made no mention of the claimed right to assignment of the mortgage, was unambiguous. *767 Third,* 812 N.Y.S.2d at 10. Because there was no ambiguity, the contract contained a merger clause, and the contract was entered into between sophisticated parties, the court would not consider evidence of industry practice or custom. *Id.*

In this case, as discussed above, the Credit Agreement explicitly and unambiguously provides for

amendment by agreement of a majority of the lenders. Silence regarding how to negotiate these amendments does not create an ambiguity. Allowing extrinsic evidence of industry customs and course of dealing would contradict this right to amend with the consent of fewer than all of the lenders by requiring negotiation/notice to all of the lenders. As in *767 Third*, the parties are sophisticated and the Credit Agreement contained a merger clause. In conclusion, the Court will not consider the Plaintiffs' extrinsic evidence in interpreting this unambiguous contract to create a right that contradicts the explicit terms of the contract. *See Gill v. Bowne Global Solutions, Inc.*, 8 A.D.3d 339, 777 N.Y.S.2d 712, 713 (N.Y. App. Div. 2004) (refusing to consider parole evidence of course of dealing in a breach of contract and implied covenant of good faith and fair dealing action because the contract was unambiguous); *Jofen v. Epoch Biosciences, Inc.*, 2002 U.S. Dist. LEXIS 12189, 2002 WL 1461351, at *9 (S.D.N.Y. 2002) (finding extrinsic evidence of industry custom irrelevant because the contract was unambiguous and dismissing the implied covenant of good faith and fair dealing claim because it was inconsistent with the express terms of the contract). The Court **GRANTS** the Defendants' Motion to Dismiss the Plaintiffs' breach of contract and duty of good faith and fair dealing claims and will now turn to the Defendants' arguments with respect to the Plaintiffs' tort claims.

D. Tort Claims

1. Fraud

The Defendants move to dismiss the Plaintiffs' fraud claim arguing that it relies on silence or omissions (as opposed to affirmative misrepresentations) and that Texas law does not impose liability for silence absent a special duty to speak such as a fiduciary duty. (Mot. 20-21). The Defendants claim that because there is no special relationship between the parties, the fraud claim must fail. (*Id.* at 21). The Plaintiffs first respond by stating that they have alleged an affirmative misrepresentation. (Resp. 19). The Plaintiffs also claim that failure to disclose or silence constitutes fraud when there is a duty to disclose. (*Id.*). According to the Plaintiffs, the fiduciary relationship is only one situation out of which the duty to disclose arises, and their claim falls into one of the other situations. (*Id.* at 20).

a. Fraud Based on an Affirmative Misrepresentation

In Texas, an individual may base a fraud claim on either an affirmative false representation or a nondisclosure. *See Jones v. Texas Dep't of Protective & Regulatory Servs.*, 85 S.W.3d 483, 491 (Tex. App. – Austin 2002, pet. denied) (citation omitted) ("[fraud] may consist of both active misrepresentation and passive silence."); *see also Dorsey v. Portfolio Equities Inc.*, 540 F.3d 333, 2008 U.S. App. LEXIS 17115, 2008 WL 3274082, at *5 (5th Cir. 2008) (listing the

elements of fraud based on both an affirmative false representation and nondisclosure). The Plaintiffs allege that their fraud claim is based on both theories. A fraud claim based on an affirmative misrepresentation consists of "a material misrepresentation, which was false, and which was either known to be false when made or was asserted without knowledge of its truth, which was intended to be acted upon, which was relied upon, and which caused injury." *Formosa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 47 (Tex. 1998) (quotations omitted).

The Plaintiffs claim that the Defendant engaged in an affirmative misrepresentation when they "lied to the Highland Funds regarding the proposed terms of the amendment made to the lenders." (Resp. 19). In support of this claim they point to their petition:

> Defendants represented to the Highland Funds that Term Lenders accepting the proposed amendment would receive a fee in the amount of 75 basis points. Defendants' representation was deliberately false. Defendants were secretly proposing an amendment fee of 125 bps to certain other Lenders. Defendants intentionally made the misrepresentations to the Highland Funds to induce the Highland Funds to refrain from consenting to the terms of the proposed amendment and to deprive the Highland Funds of the Enhanced Amendment Fee.

(Pet. §§ 55-56). Nowhere in their petition do the Plaintiffs allege that the Defendants made an affirmative representation that they would offer all of the lenders the same amendment fee. They also have not properly pled that the statement that term lenders that accepted the proposed amendment would receive 75 bps was false *at the time it was made.* (*See* Reply 2 ("That defendants subsequently reached agreement on different terms with other lenders does not, under any reasonable or rational understanding of the English language, render the earlier offer [of 75 bps] 'a lie' or 'false.'"). The allegation, quoted above, that "Defendants' representation was deliberately false" is insufficient, particularly considering the other allegations in the petition. Earlier in their petition, the Plaintiffs recite the events surrounding the proposed amendments in chronological order. They state that on December 5, 2007, the Agent circulated the revised proposal of an increased 75 bps amendment fee. (¶¶ 30-31). Next they contend that the Highland Funds did not accept this proposal and that the Defendants were unable to secure the necessary consents. (¶¶ 33-34). Without providing a date, the Plaintiffs then claim that the Defendants offered the enhanced 125 bps behind closed doors to the other lenders. (¶ 35). While the exact time frame is vague, it appears from the petition that the Defendants made the 75 bps offer; it was rejected; and then the Defendants made the 125 bps offer to the select lenders. The Plaintiffs' Response to the Motion to Dismiss confirms this reading of the petition: "Defendants followed this practice [of circulating proposed

amendments to all of the Lenders] for the first amendment, the proposed *second amendment*, and the revised proposed second amendment . . . Defendants, behind closed doors and *not* via Intralinks, *later* offered select lenders an Enhanced Amendment Fee." (Resp. 21 (emphasis added)). While, as discussed below, the Plaintiffs' petition may support a claim that the 75 bps offer was an incomplete disclosure or became false or misleading when the Defendants later offered an enhanced amendment fee, it does not support a claim that the 75 bps offer was false at the time it was made. Accordingly, the Court agrees with the Defendants that the Plaintiffs have not asserted a fraud claim based on an affirmative misrepresentation.

b. Fraud Based on Failure to Disclose

Having determined that the Plaintiffs have not asserted a fraud claim based on an affirmative misrepresentation, the Court turns to the Plaintiffs' next argument – that even if their fraud claim is characterized as a nondisclosure, the Defendants' contention that there was no duty to disclose still fails. In Texas, the Plaintiffs may state a fraud claim based on nondisclosure if they allege that "the Defendants concealed or failed to disclose a material fact that they knew [the Plaintiffs were] ignorant of or did not have the opportunity to discover, that [the Defendants] intended to induce [the Plaintiffs] to take some action by concealing or failing to disclose the material fact, and that [the Plaintiffs] suffered as a result of acting

on the Defendants' nondisclosure." *Dorsey,* ___ F.3d ___, 2008 U.S. App LEXIS 17115, 2008 WL 3274082, at *5 (citing *Bradford v. Vento,* 48 S.W.3d 749, 754-55 (Tex. 2001)). Fraud based on nondisclosure also requires that a plaintiff demonstrate that the defendant had a duty to disclose that material fact. *Id.*

There has been a debate in Texas jurisprudence regarding whether a duty to disclose exists absent a fiduciary relationship. In *Bradford,* the Supreme Court of Texas recognized that "[s]everal [Texas] courts of appeals have held that a general duty to disclose information may arise in an arm's-length business transaction when a party makes a partial disclosure that, although true, conveys a false impression." *Bradford,* 48 S.W.3d at 755 (citations omitted). The court also acknowledged that The Restatement (Second) of Torts section 551 recognized a general duty to disclose in a commercial setting. *Id.* The court then stated, "We have never adopted section 551. But even if we were to adopt such a general duty, there is no evidence to support the jury's liability finding under the submitted jury charge." *Id.* at 756 (citation omitted). Citing this case, the Fifth Circuit Court of Appeals, in a negligent misrepresentation case, concluded that there was no fiduciary or confidential relationship between the parties and that no duty to disclose arose. *Coburn Supply Co., Inc. v. Kohler Co.,* 342 F.3d 372, 377-78 (5th Cir. 2003). However, in two subsequent decisions, the Fifth Circuit recognized duties to disclose absent a fiduciary

duty. *Rimade Ltd. v. Hubbard Enters., Inc.*, 388 F.3d 138, 143 (5th Cir. 2004) (recognizing that "a speaker making a partial disclosure assumes a duty to tell the whole truth even when the partial disclosure was not legally required."); *Lewis v. Bank of Am.*, 347 F.3d 587, 588 (5th Cir. 2003) (citing *Union Pac. Res. Group, Inc. v. Rhone-Poulenc, Inc.*, 247 F.3d 574, 586 (5th Cir. 2001) (a pre-*Bradford* case) (recognizing a duty to speak when "(1) a confidential or fiduciary duty relationship exists between the parties; or (2) one party learns later that his previous statement was false and misleading; or (3) one party knows that the other party is relying on a concealed fact and does not have an equal opportunity to discover the truth; or (4) one party voluntarily discloses some but less than all material facts, so that he must disclose the whole truth, i.e., all material facts, lest his partial disclosure convey a false impression.")

Recognizing an inconsistency in the cases, the Fifth Circuit in *United Teachers* later stated:

> A reasonable jurist might well conclude, certainly after *Bradford,* that a duty to disclose exists in Texas only in the context of a confidential or fiduciary relationship. This court has so held in *Coburn,* the only Fifth Circuit case that discusses the relevant portion of *Bradford.* However, apart from *Coburn,* it would be fair to say that courts after *Bradford* (including this court) have not gotten the message, but have instead continued to find that a duty to disclose can exist in Texas

> absent a confidential or fiduciary relationship. (citing several cases).

United Teacher Assocs. Ins. Co. v. Union Labor Life Ins. Co., 414 F.3d 558, 566 (5th Cir. 2005). Unfortunately, the Fifth Circuit did not decide the issue because it found that the fraud claim failed on other grounds. *Id.* However, in a freshly minted opinion decided this month, the Fifth Circuit recognized a duty to disclose absent a fiduciary duty: "A duty to disclose may arise 'where one makes a representation and fails to disclose new information that makes the earlier representation misleading or untrue.'" *Dorsey*, ___ F.3d ___, 2008 U.S. App. LEXIS 17115, 2008 WL 3274082, at *5 (quoting *Newby v. Enron Corp.* (*In re Enron Corp. Sec., Derivative & "ERISA" Litig.*), 388 F.Supp. 2d 780, 788 (S.D. Tex. 2005)). Furthermore, Texas court of appeals cases have recognized a duty to disclose in contexts other than a fiduciary relationship. *See Solutioneers Consulting, Ltd. v. Gulf Greyhound Partners, Ltd.*, 237 S.W.3d 379, 385 (Tex. App. – Houston [14th Dist.] 2007, no pet.); *Four Bros. Boat Works, Inc. v. Tesoro Petroleum Cos.*, 217 S.W.3d 653, 670-71 (Tex. App. – Houston [14th Dist.] 2006, pet. denied). Based on the post-*Bradford* (and post-*Coburn*) Fifth Circuit and Texas court of appeals cases, the Court will assume that a duty to disclose may arise in four situations under Texas law: (1) when there is a "confidential or fiduciary relationship"; (2) "when one voluntarily discloses information, he has a duty to disclose the whole truth;" (3) "when one makes a representation, he has a duty to disclose

new information when he is aware the new information makes the earlier representation misleading or untrue;" and (4) "when one makes a partial disclosure and conveys a false impression, he has a duty to speak." *Four Bros.*, 217 S.W.3d at 670-71; *Newby*, 388 F.Supp. 2d at 788.

The Plaintiffs do not offer a basis for the Court to find the existence of a fiduciary relationship. Instead, the Plaintiffs rely on the other three situations in which a duty to disclose arises. According to the Plaintiffs, the Defendants voluntarily disclosed the 75 bps offer and thus were bound to disclose the whole truth. (Resp. 21). The Plaintiffs argue that when the Defendants made the initial disclosure, they had the duty to supplement this information if it became false or misleading when they offered the secret new amendment fee. (*Id.*). The Court concludes that the Plaintiffs have sufficiently alleged the existence of a duty to disclose to survive the Defendants' Motion to Dismiss their fraud claims. Accordingly, the Court **DENIES** the Motion to Dismiss the fraud claims.

2. Negligent Misrepresentation

The Defendants next move to dismiss the Plaintiffs' claim for negligent misrepresentation. In Texas, the elements of a cause of action for negligent misrepresentation are as follows:

> (1) the defendant's making a representation in the course of its business, or in a transaction in which it has a pecuniary interest;

> (2) the defendant's supplying "false information" for the guidance of others in their business; (3) the defendant's failure to exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff's suffering pecuniary loss by justifiably relying on the representation.

Beal Bank, S.S.B. v. Schleider, 124 S.W.3d 640, 651 (Tex. App – Houston [14th Dist.] 2003, pet. denied) (citing *Allied Vista, Inc. v. Holt,* 987 S.W.2d 138, 141 (Tex. App. – Houston [14th Dist.] 1999, pet. denied) (citing *Fed. Land Bank Ass'n of Tyler v. Sloane,* 825 S.W.2d 439, 442 (Tex. 1991))).

The Defendants argue first that this claim fails for the same reason as the fraud claim – that a negligent misrepresentation claim based on nondisclosure cannot be maintained absent a fiduciary or special relationship. For this proposition, the Defendants cite two cases. In the first case, *Fleming,* the court stated that generally a duty to disclose only arises out of a confidential or fiduciary relationship. *Fleming v. Tex. Coastal Bank of Pasadena,* 67 S.W.3d 459, 461 (Tex. App. – Houston [14th Dist.] 2002, pet. denied). However, the court also recognized that "[t]his Court has found a general duty to disclose information in arm's-length business transactions if a party makes a partial disclosure that, although true, conveys a false impression." *Id.*; *see also Jetpay Merch. Servs., LLC v. Miller,* 2007 U.S. Dist. LEXIS 68605, 2007 WL 2701636, at *5 (N.D. Tex. 2007) (citing *Tr. of the Nw. Laundry & Dry Cleaners Health & Welfare Trust*

Fund v. Burzynski, 27 F.3d 153, 157 (5th Cir. 1994)) (stating, in the context of a negligent misrepresentation claim, that a duty to correct a prior false or misleading statement arises even without a special relationship); *Nazareth Int'l, Inc. v. J.C. Penney Corp., Inc.*, 2005, U.S. Dist. LEXIS 14473, 2005 WL 1704793, at *6 (N.D. Tex. 2007) (same). The second case that the Defendants cite is *Coburn*, 342 F.3d 372. As the Court has already discussed above, it will follow the Fifth Circuit and Texas court of appeals cases decided after *Coburn* that have held that a duty to disclose can arise absent a fiduciary duty.

The Defendants next contend that the Plaintiffs have failed to demonstrate any damage suffered independent of the breach of contract. (Mot. 21). The Defendants are correct that a claim of negligent misrepresentation must include an injury independent of damages for the breach of contract claim. *Cessna Aircraft Co. v. Aircraft Network, LLC.*, 213 S.W.3d 455, 467 (Tex. App. – Dallas 2006, pet. denied) (citing *D.S.A. Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 663-64 (Tex. 1998)). The Plaintiffs claim that they were damaged because they did not receive the amendment fee. As this Court has already determined, and the Defendants have repeatedly argued, the Defendants have not breached the Credit Agreement and the Credit Agreement does not provide for a right to an amendment fee. (Mot. 2 ([N]othing in the credit agreement or any other agreement between plaintiffs and defendants provides for the fees."); Reply 1 ("§ 9.02 of the Credit Agreement, which

expressly governs amendments, is unambiguous and does not provide plaintiffs with the 'right' to receive amendment fees . . . "); (Reply 6 ("[N]othing in the Credit Agreement entitles plaintiffs to amendment fees . . . ")). Therefore, the Court concludes that the Plaintiffs' injury for the negligent misrepresentation claim does not arise from the Credit Agreement and is independent from the dismissed breach of contract claim. The Motion to Dismiss the Plaintiffs' negligent misrepresentation claim is **DENIED**.

3. Conspiracy to Commit Fraud

The Defendants move to dismiss the Plaintiffs' conspiracy to commit fraud claim arguing that the Plaintiffs fail to state a claim because they have not alleged facts that indicate that the Defendants participated in an underlying fraud. (Mot. 22). Once again, the Court finds that Plaintiffs have adequately pled an underlying fraud action and that their conspiracy claims are likewise adequately pled. Therefore, the Motion to Dismiss the fraud claim is **DENIED**.

4. Aiding and Abetting Fraud

The Defendants seek the dismissal of the Plaintiffs' aiding and abetting fraud claim. The Defendants argue that the claim fails for the same reasons as the Plaintiffs' fraud claim and that Texas law does not recognize a tort in aiding and abetting fraud that is distinct from conspiracy to commit fraud. The Court rejects the first argument because the Plaintiffs'

fraud claim survives. As for the second argument, the Texas Supreme Court has declined to decide whether aiding and abetting fraud is unique from a conspiracy claim. *See Ernst & Young, L.L.P. v. Pac. Mut. Life Ins. Co.*, 51 S.W.3d 573, 583 n.7 (Tex. 2001). However, a Texas court of appeals court recently stated that no Texas cases support the idea that aiding and abetting fraud is a tort separate from conspiracy. *O'Kane v. Coleman*, 2008 Tex. App. LEXIS 4908, 2008 WL 2579832, at *5 (Tex. App. – Houston [14th Dist.] 2008); *see also Newby v. Enron Corp.* (*In re Enron Corp. Sec., Derivative & "ERISA" Litig*), 2006 U.S. Dist. LEXIS 90526, 2006 WL 3716669, at *8 & n.7 (S.D. Tex. 2006) (agreeing that Texas has not clearly recognized a cause of action for aiding and abetting common law fraud and stating that because the plaintiffs also pled conspiracy to commit fraud, the aiding and abetting claim was redundant and unnecessary). Since Texas does not recognize such a cause of action, the Plaintiffs' claim for aiding and abetting fraud is **DISMISSED**.

5. Economic Loss

The Defendants' final argument has been partially addressed above in Part II.D.2. They argue that the tort claims are the contract claims repled as torts and that they cannot receive exemplary damages for breach of contract claims. (Mot. 23). They further argue that when the injury is only economic loss to the subject of the contract, the action sounds in contract alone. (*Id.*). The rule on which the Defendants

rely is the economic loss rule or the independent injury doctrine. Under Texas law, the economic loss rule may prevent a plaintiff from recovering in tort for purely economic loss where a contract governs the parties' relationship. *Century Prods. Co. v. Cosco, Inc.*, 2001 U.S. Dist. LEXIS 20328, 2001 WL 1577607, at *2 (N.D. Tex. 2001) (Boyle, J.) (citing *Sw. Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 494-95 (Tex. 1991)). In determining whether the economic loss rule prohibits recovery on a tort claim, the court should look at the source of the duty that was breached as well as the nature of the party's injury. *DeLanney*, 809 S.W.2d at 494-95. If the defendant's duty to the plaintiff arises only from the contract between the parties, plaintiff's claim is usually a contractual claim only. *Id.* at 494. On the other hand, if the contract does not create the defendant's duty to the plaintiff, then the claim may sound in tort as well as in contract. *Id.* Nevertheless, "[w]hen the only loss or damage is to the subject matter of the contract, the plaintiff's action is ordinarily on the contract." *Id.*

Applying *DeLanney*, the Court will now consider the source of the duty and the nature of the injury. First, the Court has already determined that the Defendants' duty to disclose did not arise from the contract. Instead the duty arose because the Defendants allegedly made a partial or misleading disclosure or a disclosure that later became misleading or untrue. This duty would arise regardless of whether the parties had a contractual relationship. Second, as discussed above, the Credit Agreement never mentions

or provides for an amendment fee. Therefore, the Plaintiffs' loss is not the subject matter of the contract. In conclusion, the Court finds that because the source of the duty and the injury are independent from the contract, the economic injury rule does not apply.

III. Conclusion

For the foregoing reasons, the Defendants' Motion to Dismiss is GRANTED IN PART AND DENIED IN PART. The Motion to Dismiss the breach of contract, breach of duty of good faith and fair dealing, and aiding and abetting fraud claims is **GRANTED**. The Motion to Dismiss the fraud, negligent misrepresentation, and conspiracy to commit fraud claims is **DENIED**.

SO ORDERED.

SIGNED August 27th, 2008

/s/ Jane J. Boyle
JANE J. BOYLE
UNITED STATES
DISTRICT JUDGE

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 09-10554

HIGHLAND CRUSADER OFFSHORE PARTNERS LP; HIGHLAND CREDIT STRATEGIES FUND; HIGHLAND DISTRESSED OPPORTUNITIES INC; HIGHLAND FLOATING RATE ADVANTAGE FUND; HIGHLAND FLOATING RATE LLC; RESTORATION OPPORTUNITIES FUND; HIGHLAND CREDIT OPPORTUNITIES FUND CDO LP; HIGHLAND FUNDS I, on behalf of its Highland High Income Series,

Plaintiffs-Appellants

v.

LIFECARE HOLDINGS INC; LCI HOLDCO LLC; JP MORGAN CHASE BANK, NA,

Defendants-Appellees

Appeal from the United States District Court
for the Northern District of Texas, Dallas

ON PETITION FOR REHEARING AND REHEARING EN BANC

(Filed Jun. 14, 2010)

(Opinion 5/10/2010, 5 Cir., _____, _____, F.3d_____)

Before DeMOSS, ELROD, and HAYNES, Circuit Judges.

PER CURIAM:

(X) The Petition for Rehearing is DENIED and no member of this panel nor judge in regular, active service on the court having requested that the court be polled on Rehearing En Banc, (FED. R. APP. P. and 5TH CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) The Petition for Rehearing is DENIED and the court having been polled at the request of one of the members of the court and a majority of the judges who are in regular active service and not disqualified not having voted in favor, (FED. R. APP. P. and 5 CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) A member of the court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service and not disqualified not having voted in favor, Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

6-14-10

/s/ [Illegible]
United States Circuit Judge

No. 09-10554

United States Court of Appeals, Fifth Circuit

HIGHLAND CRUSADER OFFSHORE PARTNERS, L.P.; HIGHLAND CREDIT STRATEGIES FUND; HIGHLAND DISTRESSED OPPORTUNITIES, INC.; HIGHLAND FLOATING RATE ADVANTAGE FUND; HIGHLAND FLOATING RATE, LLC; RESTORATION OPPORTUNITIES FUND; HIGHLAND CREDIT OPPORTUNITIES FUND CDO L.P.; and HIGHLAND FUNDS I, on behalf of its HIGHLAND HIGH INCOME SERIES,

Appellants,

v.

LIFECARE HOLDINGS, INC., LCI HOLDCO, LLC, and JPMORGAN CHASE BANK, N. A.,

Appellees.

On Appeal from the United States District Court
for the Northern District of Texas
Dallas Division
No. 3:08-CV-102

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CERTIFICATE OF INTERESTED PERSONS

No. 09-10554
United States Court of Appeals, Fifth Circuit

HIGHLAND CRUSADER OFFSHORE PARTNERS, L.P.; HIGHLAND CREDIT STRATEGIES FUND; HIGHLAND DISTRESSED OPPORTUNITIES, INC.; HIGHLAND FLOATING RATE ADVANTAGE FUND; HIGHLAND FLOATING RATE, LLC; RESTORATION OPPORTUNITIES FUND; HIGHLAND CREDIT OPPORTUNITIES FUND CDO L.P.; and HIGHLAND FUNDS I, on behalf of its HIGHLAND HIGH INCOME SERIES,

Appellants,

v.

LIFECARE HOLDINGS, INC., LCI HOLDCO, LLC, and JPMORGAN CHASE BANK, N. A.,

Appellees.

Under Rule 28.2.1 these persons and entities have an interest in the outcome of this case. These

identifications are made so that the judges of this court may evaluate disqualification or recusal.

Highland Crusader Offshore Partners, L.P.
Highland Credit Strategies Fund
Highland Distressed Opportunities, Inc.
Highland Floating Rate Advantage Fund, Highland Floating Rate, LLC
Restoration Opportunities Fund
Highland Credit Opportunities Fund CDO, L.P.
Highland Funds I, on behalf of its Highland High Income Series
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35(b)(1) STATEMENT REGARDING THE NEED FOR *EN BANC* DETERMINATION

This proceeding raises questions of exceptional importance warranting *en banc* determination, for two reasons. First, the Panel's opinion conflicts with opinions of the Second Circuit and completely ignores applicable New York law.[1] Second, the Panel's opinion

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[1] *See, e.g., India.com, Inc. v. Sabdeep Dalal*, 324 Fed. Appx. 59, 2009 U.S. LEXIS 8962 (2d Cir. April 28, 2009) (upholding good faith and fair dealing claim under New York law); *Tractebell Energy Mktg., Inc. v. AEP Power Mktg., Inc.*, 487 F.3d 89, 98-99 (2d Cir. 2007) ("Under New York law, a covenant of good faith and fair dealing is implicit in all contracts during the course of contract performance. . . . In determining whether a party has breached the covenant of good faith and fair dealing, a court must examine not only the express language of the parties' contract, but also any course of performance or course of dealing that may exist between the parties.") (citations omitted); *British Int'l Ins. Co. v. Seguros la Republica, S.A.*, 342 F.3d 78, 83-4 (2d Cir. 2003) (noting that industry custom and usage may be used to supply an omitted term of a contract); *see also Columbia Artists Mgmt., LLC v. Swenson & Burnakus, Inc.*, No. 05 Civ. 7314 (LBS), 2010 U.S. Dist. LEXIS 32879, at *4-5 (S.D.N.Y. Mar. 30, 2010) ("Under New York law, a contract must be construed according to the custom and use prevailing in a particular trade. Industry custom may be used to provide a missing term when a contract is silent on an issue.") (citations omitted); Richard A. Lord, *WILLISTON ON CONTRACTS*, 34:7 (4th ed. 2009) ("Parol evidence of usage is also admissible to supply a missing or omitted term or provision to a contract when the contract is silent as to that particular term or provision. So even

(Continued on following page)

has far-reaching, potentially disastrous ramifications which could impact dozens if not hundreds of syndicated loans totaling nearly a trillion dollars of debt.

This case involves a $255 million loan to LifeCare by roughly 25 lenders. The Panel's ruling essentially wrote into the loan agreement a new provision which permitted LifeCare to modify the terms of that quarter-billion dollar agreement by entering into a secret side deal[2] with any individual lender. Because the applicable provisions in this loan agreement are essentially boiler plate and because the vast majority of loans of this nature are administered in the same manner, the Panel's decision will encourage borrowers to pursue similar secret side deals at a time when transparency is absolutely essential. At a minimum, the Panel's ruling throws into disarray how the dozens if not hundreds of similar loans, involving nearly a trillion dollars in debt, can be modified. Every witness in this case, including Appellees' witnesses, testified they could not identify a single instance in which a borrower was permitted to or

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when a contract is not ambiguous, if is silent on a given issue, evidence of industry custom and usage may be admitted to explain or supplement the contract, so long as such evidence is consistent with and does not contradict the express terms of contract.").

[2] The Panel's questions at oral argument reflected that it determined this case did indeed involve a secret side deal and Appellees' responses to those questions all but acknowledged same.

even attempted to enter into a secret side deal.[3] Rather, every proposed amendment is always brought to all the lenders' attention by posting the proposed amendment, related information, and consent forms to a secure website, such as Intralinks, for all lenders to review.[4]

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[3] *See* Deposition of Jenny Lee, dated January 22, 2009 ("*Lee Deposition*") pp. 112:15-113:2 **(USCA5 1389-1390)**; Deposition of Andrew O'Brien dated January 23, 2009 ("*O'Brien Deposition*") p. 23:15-22 **(USCA5 1417, *RE 93*)** ("Q. So it is J.P.Morgan's practice, based on your testimony, is it not, to disclose all relevant information to lenders in its role as either arranger or agent bank under a syndicated lending transaction, is that correct? . . . A. Yes, that is correct."), pp. 45:23-46:11 **(USCA5 1422, *RE 95*)** ("Q. Can you ever recall an instance in which J.P. Morgan, acting in its capacity as either arranger or administrative agent bank, has not disclosed to all lenders the amendment fee that will ultimately be paid to lenders that consent to an amendment under a credit agreement? . . . Q. Any instance whatsoever? A. I can't recall any. Q. None, correct? . . . A. I can't recall any, correct."), pp. 58:20-59:3 **(USCA5 1423, *RE 96*)** ("Q. Can you ever recall an instance in which the amendment fees being paid to consenting lenders under a credit agreement were not disclosed to all lenders in a syndicated lending transaction? A. Thinking back right now, I cannot recall any specific example that would be similar to this situation."); Deposition of JPMorgan Chase Bank N.A. by Jackson Merchant dated November 18, 2008 ("*JPMorgan (Merchant) Deposition*") p. 181:16-21 **(USCA5 838, *RE 69*)** ("Q. Can you think of any instance in which an amendment was not posted in a deal on which you have worked? . . . A. No, I can't think of any instance.").

[4] **USCA5 1387, 1391, 1392, 1394-1395, *RE 82-86*** (*Lee Deposition*); Deposition of Phillip Douglas, dated January 12, 2009 ("*Douglas Deposition*") **(USCA5 1404-1405, *RE 72*)**; **USCA5 1417-1418, 1423, *RE 93-94, 96*** ("O'Brien Deposition").

Although the loan agreement was silent as to the procedure for amending that agreement, and despite the fact that the industry standard and practice was to fully disclose proposed amendments to all lenders and give every lender an opportunity to consent, the Panel essentially ruled that LifeCare was free to pursue secret side deals. This ruling is contrary to New York law, which requires that when an agreement is silent on an issue, industry standard and practice and the parties' expectations (all of which were uncontested in this case) must be read into the agreement by the court.[5] The ruling also ignored New York law providing that LifeCare had a duty of good faith and fair dealing requiring that it (1) abide by

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[5] *Gulf Int'l Bank B.S.C., N.Y. Branch v. Othman*, No. 93 Civ. 3161 (CSH), 1994 WL 116015, at *3 (S.D.N.Y. Mar. 28, 1994) ("[I]t is an established principle of contract law that if an agreement is silent as to a material term, courts may imply such term from external sources, including a course of dealing between the parties prior to the agreement."); *Metro-Goldwyn-Mayer, Inc. v. Scheider*, 360 N.E.2d 930, 931 (N.Y. 1976) ("The only essential term as to which there was no finding of articulated understanding was the starting date for filming the television series. This term was supplied by a finding of the trial court based on proof of established custom and practice in the industry, of which both parties were found to be aware, set in the context of the other understandings reached by them."); *Columbia Artists Mgmt., LLC v. Swenson & Burnakus, Inc.*, No. 05 Civ. 7314 (LBS), 2010 U.S. Dist. LEXIS 32879, at *4-5 (S.D.N.Y. Mar. 30, 2010) ("Under New York law, a contract must be construed according to the custom and use prevailing in a particular trade. Industry custom may be used to provide a missing term when a contract is silent on an issue.") (citations omitted).

obligations which a reasonable person in plaintiff's position would be justified in understanding were included in the agreement, (2) "[w]here the contract contemplates the exercise of discretion, . . . not act arbitrarily or irrationally in exercising that discretion"[6] and (3) "eschew . . . targeted malevolence."[7] The uncontroverted evidence reflects that Appellees engaged in targeted malevolence and irrational behavior designed to harm Highland, even at their own expense.[8] Among other things, Appellees declared a "battle royale with Highland;" delayed sending Highland contact information for other lenders in hopes of thwarting Highland's efforts to contact those other lenders; agreed to pay other lenders a significantly higher consent fee without even considering whether Highland would accept a lower fee; and made the affirmative decision to mislead Highland by not posting the executed amendment to Intralinks, thereby hiding the fact that other lenders were paid a higher consent fee."[9]

The impact of this ruling has such far-reaching implications that if the *en banc* Panel is not inclined to consider the matter, Appellants request that the Panel certify these issues to the highest court in the

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[6] *Dalton v. Educ. Testing Serv.*, 663 N.E.2d 289, 291 (N.Y. 1995).

[7] *Richbell Info. Servs. v. Jupiter Partners, L.P.*, 765 N.Y.S.2d 575, 587 (N.Y. App. Div. 2003).

[8] *See infra* notes 22-27 and accompanying text.

[9] *See infra* notes 22-27 and accompanying text.

State of New York pursuant to New York State Constitution Article 6, §3(b)(9).

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I.

STATEMENT OF ISSUES THAT MERIT *EN BANC* CONSIDERATION

1. Did the Panel misinterpret the law and render an opinion inconsistent with New York State Court and Federal Circuit Court opinions by

holding that Appellees did not breach their duty of good faith and fair dealing by entering into a secret side deal, where the evidence established that a reasonable person in Highland's position would expect that such a secret side deal was prohibited under the Credit Agreement, was contrary to the industry standard, and reflected an irrational exercise of discretion and targeted malevolence?

2. Did the Panel's opinion misinterpret New York law and conflict with New York State Court and Federal Circuit Court opinions by holding that Appellees did not breach the Credit Agreement, where the Credit Agreement was silent as to how LifeCare could solicit lender consents and the parties' expectations and unwavering industry standard precluded secret side deals?

3. Did the Panel's opinion misstate New York law and conflict with New York State Court and Federal Circuit Court opinions by holding that Appellees did not commit fraud by first failing to disclose the negotiations and secret side deal and then failing to reveal the true terms of the amendment?

II.

COURSE OF PROCEEDINGS

The District Court issued a Memorandum Opinion, dated August 27, 2008, granting Defendants' Motion to Dismiss Plaintiffs' claims for breach of contract and breach of duty of good faith and fair dealing. On April 21, 2009, the District Court issued a

Memorandum Order granting summary judgment dismissing Plaintiffs' remaining claims for fraud, conspiracy, and negligent misrepresentation.

Appellants timely appealed both orders. The Panel affirmed the District Court's orders on May 10, 2010.

III.

STATEMENT OF FACTS

LifeCare borrowed $255 million under the subject Credit Agreement. The debt was held by roughly 25 lenders, some of whom were Appellants. In April 2007, LifeCare sought to amend the Credit Agreement to get relief from certain debt covenants. To this end, Appellees posted to Intralinks amendment materials including a draft amendment to the Credit Agreement, a lenders' presentation, and an invite letter.[10] Every witness in this case testified that this method was the industry standard – when a borrower to a multi-lender agreement sought an amendment, the proposed amendment and other information would be posted to a secure website, such as Intralinks, where it would be available to all of the lenders to review and either consent to (and receive a

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[10] **USCA5 932-967**; *see also* Stipulated Facts p. 7, ¶ 11 **(USCA5 1894).**

consent fee) or decline.[11] The proposed amendment provided that an amendment fee of 25 basis points would be paid to any consenting lender.[12] The requisite lenders, including Highland, consented to the proposed amendment and on May 2, 2007, the amendment passed.[13]

In November 2007, LifeCare again sought to amend the Credit Agreement. LifeCare repeated its prior practice and acted in accordance with the lenders' expectations and industry standards and notified the lenders of LifeCare's desire by posting an invite letter and amendment materials on Intralinks.[14] This time, LifeCare offered a 50 basis point increase in the lenders' spread and an amendment fee of 25 basis points for each consenting lender.[15] Consistent with industry standards, the lenders' expectations, and LifeCare's prior conduct, the proposed amendment was posted to Intralinks and every lender had the opportunity to consent or decline. This time, however, neither Highland nor the requisite number of lenders consented and, thus, the amendment did not pass.[16]

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[11] **USCA5 1387, 1391, 1395, *RE 82-83, 86*** (*Lee Deposition*); **USCA5 1404-1405, *RE 72*** (*Douglas Deposition*); **USCA5 1417-1418, 1423, *RE 93-94, 96*** (O'Brien Deposition).

[12] **USCA5 963.**

[13] **USCA5 986.**

[14] **USCA5 999-1003** (invite letter); **1004-1035** (lenders' presentation).

[15] **USCA5 1033, *RE 62*** (amendment overview).

[16] Stipulated Facts p. 8, ¶ 25 **(USCA5 1895).**

This required LifeCare, for a third time, to repeat the amendment process. It did so by again posting amendment materials to Intralinks, including a new proposed amendment which increased the amendment fee to 75 basis points.[17] Thus, once again, consistent with LifeCare's two prior attempts to solicit amendment consents, the lenders' expectations, and industry standard, the proposed amendment was posted on Intralinks for all of the lenders to either consent to, or decline. As of December 6, 2007, neither Highland nor the required lenders had consented to the amendment.[18]

Around that date, LifeCare entered into secret negotiations with two lenders, Symphony and Quadrangle, where they discussed paying Symphony and Quadrangle a 125 basis points amendment fee.[19] Symphony and Quadrangle accepted the 125 basis points, consented to the amendment, and thereby putatively provided LifeCare with the requisite number of lenders for the amendment to pass.

The other lenders were not aware of the secret side deal and, in fact, based on LifeCare's prior conduct and the industry standard, believed that the only deal being offered to anyone was the 75 basis

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[17] Stipulated Facts p. 9, ¶¶ 30-32 **(USCA5 1896).**

[18] Stipulated Facts p. 9, ¶¶ 30-32 **(USCA5 1896).**

[19] Stipulated Facts p. 10, ¶ 34 **(USCA5 1897).**

points deal still pending on Intralinks.[20] While there were rumors that LifeCare had been discussing a 125 basis point payment, because doing a side deal where LifeCare would essentially buy off other lenders would be "crazy" and contrary to the lenders' expectations and industry standard, Highland believed that the only true offer was still pending on Intralinks and that if LifeCare were to up the ante to 125 basis points, that offer would be posted on Intralinks just as every other offer had been.[21]

LifeCare went out of its way to hide the secret side deal and in fact lied about it. The lies included a targeted malevolent campaign against Highland. First, Appellees declared a "battle royale with Highland . . . we need a targeted campaign . . . treat this like an election and Highland is the crazy Howard Dean!"[22] Second, although § 9.01 of the Credit Agreement required notices to be sent via overnight mail, hand delivery, telecopy or similar means, Appellees intentionally sent Highland contact information via regular mail to delay Highland's efforts to contact other lenders and potentially learn about the side deal.[23] Third, once the secret deal was completed,

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[20] *See* Deposition of Patrick Daugherty dated October 30, 2008 (*"Daugherty Deposition"*) **USCA5 1325; 1334; 1336-37**.

[21] *Id.*

[22] **USCA5 1424, *RE 100.***

[23] **USCA5 1424-25, *RE 100-01*** ("Still don't know why we had to give them the lender list so quickly . . . just for the record

(Continued on following page)

Appellees gloated "[the deal is done] and no Highland!"[24]

Fourth, recognizing their side deal was inappropriate, Appellees tried to hide their misdeeds by not posting the executed amendment on Intralinks and not disclosing on Intralinks that the consenting lenders would be paid 125 bps rather than 75 bps.[25] Instead, while the only amendment proposal on Intralinks was the 75 basis point offer, Appellees posted on Intralinks that the amendment was "now effective."[26] In doing so, Appellees made a conscious decision to mislead Appellants, internally communicating a reminder to "note that the revised 125 bps tlb fee will not be in the executed amendment doc nor posted to Intralinks, but rather funds who consented are being told they will received 125 bps. . . ."[27]

Highland doesn't have the list yet we just put it in the regular mail yesterday.").

[24] **USCA5 921, *RE 98*.**

[25] **USCA5 922, *RE 99*** ("Note that the revised 125 bps tlb fee will not be in the executed amendment doc nor posted to Intralinks but rather funds who consented are being told they will receive 125 bps instead of 75 bps.").

[26] **USCA5 1898.**

[27] **USCA5 922, *RE 99*.**

IV.

ARGUMENT AND AUTHORITIES

A. The Secret Side Deal Breached Appellees' Duties Of Good Faith And Fair Dealing.

The duty of good faith and fair dealing is implied in every contract governed by New York law.[28] A party may breach the implied duty of good faith and fair dealing even if the conduct does not breach an express term of the contract.[29] The duty applies to even discretionary rights under the contract and prohibits exercised discretion in bad faith or in a manner which would frustrate the other party's right to benefit under the agreement.[30] Also, "[w]here the contract contemplates the exercise of discretion, this pledge includes a promise not to act arbitrarily or irrationally in exercising that discretion."[31] The duty enforces promises which a reasonable person in the plaintiff's position would be justified in understanding were included in the agreement, even if not expressly

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[28] *See Dalton*, 663 N.E.2d at 291.

[29] *See Gross v. Empire Healthchoice Assurance, Inc.*, 847 N.Y.S.2d 896, 2007 N.Y. Misc. LEXIS 4962, slip op. at *4-5 (N.Y. Sup. Ct. 2007).

[30] *See Richbell Info.*, 765 N.Y.S.2d at 587; *Dalton*, 663 N.E.2d at 291.

[31] *Dalton*, 663 N.E.2d at 291.

stated.[32] The duty also imposes a duty "to eschew . . . targeted malevolence."[33]

Appellees' conduct violated the duty of good faith and fair dealing for several reasons. First, it was a targeted malevolence. The only evidence, which must be construed in the light most favorable to Highland, showed that Appellees wanted to avoid paying Highland anything, even if it meant paying other lenders more.

Second, it breached a promise which a reasonable person in Highland's position would be justified in understanding was included in the agreement – that all offers would be posted to Intralinks and that there would be no secret side deals. The only evidence, including Appellees' own admissions, demonstrated that the parties' reasonable expectations and the industry standard was that an proposed amendment would be posted to Intralinks, every lender would have the opportunity to consent to it and reap an amendment fee and that a secret side deal would be "crazy."[34]

Third, to the extent Appellees had discretion as to how they obtained consents, they exercised that

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[32] *See id.*

[33] *Richbell Info.*, 765 N.Y.S.2d at 587.

[34] **USCA5 1325, 1334, 1336-37** (*Daugherty Deposition*); **USCA5 1387, 1391, 1395, *RE 82-83, 86*** (*Lee Deposition*); **USCA5 1404-1405, *RE 72*** (*Douglas Deposition*); **USCA5 1417-1418; 1423, *RE 93-94, 96*** (*O'Brien Deposition*).

discretion arbitrarily by excluding Highland for vindictive reasons.[35] They also exercised that discretion irrationally. Any rational borrower, once determining that certain lenders would approve of the amendment for 125 bps, would go to Highland and other lenders to see if they would agree to something less than 125 bps.

Any one of these uncontested facts precluded dismissal. But the Panel concluded (1) if Highland wanted to preclude secret side deals, it should have negotiated that provision into the agreement; and (2) Highland failed to plead that Appellees' actions deprived it of any benefit that it bargained for in the Credit Agreement.[36] Both conclusions are factually and legally incorrect.

New York law reads into contracts "new" provisions as long as those provisions do not conflict with any provision already in the contract, and as long as the parties were justified in understanding that such a limitation or obligation was included in the agreement.[37] The Panel incorrectly determined that

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[35] **USCA5 1424** (*O'Brien Deposition*).

[36] Fifth Circuit Court of Appeals Panel Opinion, dated May 10, 2010 ("*Opinion*"), at 8, attached hereto as Exhibit 1.

[37] *See Dalton*, 663 N.E.2d at 291-92 ("Encompassed within the implied obligation of each promisor to exercise good faith are any promises which a reasonable person in the position of the promisee would be justified in understanding were included . . . [but] no obligation can be implied that would be inconsistent with other terms of the contractual relationship."); *Gulf Int'l Bank B.S.C., N.Y. Branch v. Othman*, No. 93 Civ. 3161 (CSH),

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Highland's request would result in "wholesale rewriting" of the contract. In fact, that is not the case because there is nothing in the Credit Agreement that even remotely discussed how LifeCare could solicit consents.[38] And while the Panel suggested that if Highland wanted to limit LifeCare's ability to enter into a secret side deal (assuming it would be foreseeable for Highland to even contemplate such malfeasance and thus protect against it), the same can be said of LifeCare – if it wanted unfettered ability to enter into secret side deals, it could have bargained for that right. No one bargained for or inserted a provision regarding solicitation because the industry standard was so clear and so consistent that no further memorialization was necessary.

1994 U.S. Dist. LEXIS 3725, at *9 (S.D.N.Y. Mar. 28, 1994) ("[I]t is an established principle of contract law that if an agreement is silent as to a material term, courts may imply such term from external sources, including a course of dealing between the parties prior to the agreement."); *Metro-Goldwyn-Mayer, Inc. v. Scheider,* 360 N.E.2d 930, 931 (N.Y. 1976) ("The only essential term as to which there was no finding of articulated understanding was the starting date for filming the television series. This term was supplied by a finding of the trial court based on proof of established custom and practice in the industry, of which both parties were found to be aware, set in the context of the other understandings reached by them.").

[38] While the Panel focused on § 9.02, that section only details how many votes are needed for a particular type of amendment and in no way discusses how those votes can be solicited. *See infra* note 41.

With respect to the Panel's determination that Highland failed to plead that LifeCare's actions deprived Highland of any benefit bargained for in the Credit Agreement, that conclusion is simply false. Highland specifically pled "Defendants breached the express and implied covenants of good faith and fair dealing in the Credit Agreement. Defendants acted in a manner that had the effect of destroying or injuring the right of Plaintiffs to receive the amendment fee with respect to the second amendment."[39] As detailed above, Highland also presented sufficient evidence supporting their allegation.[40] At a minimum, the pleadings and evidence at the motion to dismiss stage were sufficient to avoid dismissal.

B. The Secret Side Deal Breached The Parties' Credit Agreement.

The Panel's ruling rested on § 9.02, which details nothing more than what percentage of lenders must approve various amendments.[41] However, the Panel incorrectly expanded § 9.02, concluding it permits the secret side deal because it "expressly allows amendments such as this one to be made without all parties consenting and further does not provide that each consenting party must be the subject of equal

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[39] Plaintiffs' Original Petition, ¶ 50 **(USCA5 825)**.

[40] *See supra* notes 22-27 and accompanying text.

[41] Credit Agreement, § 9.02 **(USCA5 1220-1224, *LRE 18-22*)**.

inducements to consent."[42] Because the contract was silent on the issue of how to solicit consents, the Court was required to apply the parties' reasonable expectation and the industry standard and practice.[43]

The Panel also determined that § 3.12 of the Credit Agreement containing a warranty that information furnished by each side in connection with the Credit Agreement was correct, only applied to the negotiation of the original Credit Agreement, not any subsequent amendments.[44]

Section 3.12 must apply to amendments because amendments are incorporated into and become a part of the Agreement. Both executed amendments state:

> "[o]n and after the effectiveness of this Amendment, each reference in the Credit Agreement to '*this Agreement*', 'hereunder', and 'hereof' or words of like import referring

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[42] Opinion at 8.

[43] *Gulf Int'l Bank*, 1994 U.S. Dist. LEXIS 3725, at *9 ("[I]t is an established principle of contract law that if an agreement is silent as to a material term, courts may imply such term from external sources, including a course of dealing between the parties prior to the agreement."); *Metro-Goldwyn-Mayer, Inc.*, 360 N.E.2d at 931 ("The only essential term as to which there was no finding of articulated understanding was the starting date for filming the television series. This term was supplied by a finding of the trial court based on proof of established custom and practice in the industry, of which both parties were found to be aware, set in the context of the other understandings reached by them."); *Dalton*, 663 N.E.2d at 291.

[44] Opinion at 6-7.

> to the Credit Agreement . . . *shall mean and be a reference to the Credit Agreement, as amended by this Amendment.*"[45]

Also, the Amendment Consent page states:

> " . . . 'thereunder', thereof, 'therein' . . . shall mean . . . the Credit Agreement, as amended. . . ."[46]

Because the amendments are incorporated into and become a part of the Agreement, negotiation of the amendments were negotiations of the Agreement itself, thus subject to § 3.12.

Interpreting § 3.12 to exclude incorporated amendments, requires lenders to anticipate that, while material misstatements and omissions during negotiation of the original Agreement were prohibited, similar material misrepresentations and omissions are acceptable during the negotiation of amendments. Such an interpretation is not only counter-intuitive, but contrary to New York law providing that an amendment results in the creation of a new contract which supplants the affected provisions of that

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[45] Amendment No. 1 to the Credit Agreement, Section 5 (**USCA5 993, *RE 80***); Amendment No. 2 to the Credit Agreement (Blackline Version), Section 5 (**USCA5 1041, *RE 65***) (emphasis added).

[46] Amendment No. 1 to the Credit Agreement, Consent (**USCA5 996, *RE 81***); Amendment No. 2 to the Credit Agreement (Blackline Version), Consent (**USCA5 1046, *RE 66***).

contract *while leaving the balance of the original agreement intact.*[47]

C. Appellees Committed Fraud By Failing To Disclose The Secret Side Deal And Then Misrepresenting Its Terms.

The sole ground the Panel articulated for affirming the District Court's dismissal of the fraud and negligent misrepresentations claims was that Highland could not have justifiably relied on Appellees' alleged misrepresentations because Highland "collected and updated . . . information [from] other Lenders," heard of the 125 bps offer, and was told by JPMorgan that it could neither confirm nor deny whether such an offers was made.[48] Initially, the reasonableness of reliance is inherently a question of fact and not appropriate for summary judgment.[49]

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[47] *See Beacon Terminal Corp. v. Chemprene, Inc.*, 429 N.Y.S.2d 715, 717-18 (N.Y. App. Div. 1980); *Mary Matthews Interiors, Inc. v. Levis*, 617 N.Y.S.2d 39, 41 (N.Y. App. Div. 1994); *see also, Am. Home Assurance Co. v. Am. Fidelity & Cas. Co.*, 356 F.2d 690, 691-92 (2d Cir. 1966 (enforcing arbitration provision contained in original contract for dispute regarding subsequent addendum).

[48] Opinion at 9-10.

[49] *RGH Liquidating Trust v. Deloitte & Touche LLP*, 851 N.Y.S.2d 73, 2007 N.Y. Misc. LEXIS 7682, slip op. at *5-6 (N.Y. App. Div. 2007) ("Moreover, the reasonableness of the lender banks' reliance upon the Reports, both before and after the public filings, is a question of fact that would be premature to resolve on a motion to dismiss."); *Brunetti v. Musallam*, 783 N.Y.S.2d 347, 349 (N.Y. App. Div. 2004) ("The issues of material

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More importantly, the mere fact that Highland was aware of discussions or even an offer of 125 bps to other lenders is irrelevant. The only evidence, including Appellees' own admissions, detailed that if there were to be a formal offer, it would be posted on Intralinks;[50] it would be "crazy" for there to be a side deal;[51] and that the only information lenders actually **relied** upon (as opposed to just gathered for background) was that posted on Intralinks.[52] Given these facts, at a minimum, genuine issues of material fact precluded summary judgment. For the same reason, summary judgment should not have been granted denying Appellants' conspiracy to defraud claim.

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misrepresentation and reasonable reliance, essential elements of a fraud claim, are not subject to summary disposition"); *Sachs v. Adeli*, No. 603930/2003, 2006 N.Y. Misc. LEXIS 2615, at *35-6 (N.Y. Sup. Ct. Aug. 21, 2006) ("The reasonableness of the plaintiff's reliance, however, is not determinable on a summary judgment motion, absent extraordinary circumstances."); *Granite Partners, L.P. v. Bear, Stearns & Co.*, 17 F. Supp. 2d 275, 290 (S.D.N.Y. 1998) (reasonableness of reliance is question of fact).

[50] **USCA5 1325, 1334, 1336-37** (*Daugherty Deposition*); **USCA5 1387, 1391-1392, 1394-1395, *RE 82-86*** (*Lee Deposition*); **USCA5 1404-1405, *RE 72*** (*Douglas Deposition*); **USCA5 1417-1418, 1423, *RE 93-94, 96*** (*O'Brien Deposition*).

[51] **USCA5 1325; 1334; 1336-37** (*Daugherty Deposition*).

[52] **USCA5 1334** (*Daugherty Deposition*); **USCA5 1387, 1391-1392, 1394-1395, *RE 82-86*** (*Lee Deposition*); **USCA5 1417-1418, *RE 93-94*** (*O'Brien Deposition*).

V.

CONCLUSION

The Panel's opinion conflicts with established precedent; misstates New York law; misstates the facts unequivocally established on the record; and has far-reaching detrimental effects, including promoting secret side deals. Appellants respectfully request that an *en banc* panel overturn the opinion or, in the alternative, certify the question to the highest court in New York.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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